

**POLICY DEVELOPMENT & REVIEW 2010/11: APPROACH TO THE REVIEW & SETTING THE SCENE****Report of the Chief Executive****1. Purpose of Report**

- 1.1 The purpose of this report is twofold in that it seeks agreement from members in relation to the final terms of reference for this Policy Review into Money Lenders and Illegal Loan Sharks. It also looks to establish background information and set the scene for the investigation that is to follow.

**2. Background**

- 2.1 At its meeting on 14th July, 2011 following discussions that had taken place at the Cabinet meeting held on 22<sup>nd</sup> June 2011 the Committee considered the possibility of a study into the effects on communities of high interest money lenders and illegal loan sharks. The initial scoping document has been presented to the Committee and this report provides further background reference to the review topic. This report also adds structure to the review and provides a timeline for evidence gathering along with a number of potential areas to explore.

**3. Title of the Review**

- 3.1 The title of the review is suggested as 'At Any Cost: The Effects of High-Cost Credit and Illegal Loan Sharks on Local Communities'.

**4. Objectives of the Review**

- 4.1 To identify and understand the types of money lenders available to people living within Sunderland;
- 4.2 To investigate and identify the overall levels of debt, the levels of interest charged and some of the selling techniques employed by money lenders;
- 4.3 To explore the issues that members of the public face in relation to debt and the impact that money lending can have on individuals and communities as a whole, and;
- 4.4 To look at examples of good practice from across the region and country in relation to the policy review.

**5. Gathering the Evidence**

- 5.1 Research activities over the coming months will be co-ordinated by this Committee's Scrutiny Officer in consultation with the relevant directorate staff. Every effort will be made to involve Members in the research. Although alternative

opportunities may present themselves during the review, data collection techniques may include a combination of the following:

- Desktop research
- Use of secondary research e.g. surveys, questionnaires
- Evidence presented by key stakeholders
- Evidence from members of the public at meetings or focus groups
- Site visits.

5.2 The review will gather evidence from a variety of sources. The main evidence will come from information provided by council officers and external partners likely to include, though not exhaustive, the following:

- (a) Relevant Cabinet Portfolio Holders;
- (b) Trading Standards and Licensing Manager;
- (d) Head of Housing;
- (e) Gentoo Housing Group;
- (f) Citizens Advice Bureau;
- (g) Wearside First Credit Union;
- (h) Local Debt Advisors;
- (i) Police;
- (j) Welfare Rights;
- (k) Local MP's;
- (l) Members of the Public;
- (m) Community and Voluntary Groups, and;
- (n) Local Authorities and/or organisations of good practice.

## **6. Scope of the Review**

6.1 The review will consider, as part of the review process, the following issues related to loan sharks and high interest money lending:

- What is available in terms of finance/loans to Sunderland residents?
- How and why do people borrow money in Sunderland?
- Where do people find out about the various money lending schemes available?
- What levels of interest are charged by the various schemes?
- Are potential borrowers aware of the levels of interest charged?
- Are loan sharks operating in Sunderland?
- What practices do loan sharks employ?
- What effect do loan sharks have on individuals and communities?
- Are there alternatives available to people apart from high interest loan schemes and loan sharks?
- What financial advice or support groups are operating within Sunderland?
- How do people become aware of, or access such support groups?
- Is this something that central government should act upon?
- What can Sunderland learn from the Illegal money lending team?
- Are there examples of good practice from across the country?

6.2 As the review investigation develops Members may decide to reduce or widen the remit of the review to ensure that the findings are both robust and based on the evidence and research gathered.

## **7. Timescales**

7.1 Also attached for Members information is a draft timetable (Appendix 1) for the policy review which outlines the various activities and evidence gathering that will be undertaken throughout the review process. The timetable forms the basis of the review process and allows members to see the range of activities and methodologies to be employed during the evidence gathering stage. The timetable is subject to amendment and throughout the review process members will be provided with an up-to-date timetable reflecting any changes.

7.2 Members of the review committee will be invited to attend the various focus groups and visits that are to be undertaken as part of the policy review and will be kept informed of all review activities as and when they are arranged.

## **8. Setting the Scene**

### **8.1 UK Debt: Some Facts and Figures**

8.1.1 The total UK personal debt at the end of July 2011 stood at £1,451bn, with the average household debt being £8,055 (excluding mortgages) and £55,814 (including mortgages).

8.1.2 334 people a day, or every 4.31 minutes, someone will be declared insolvent or bankrupt while every 14 minutes a property is repossessed, meaning banks and building societies are writing off some £22.54m of loans on a daily basis.

8.1.3 The Citizen Advice Bureau deals with 9,072 new debt problems each working and figures released by the Consumer Credit Counselling Service (CCCS) suggest that their average client has to work until 4pm on a Wednesday, each week, just to earn enough money to repay their unsecured debts. The average person contacting CCCS in 2010 owed a total of £22,476 in unsecured debt, and faced a monthly bill of £675.52 simply to meet repayments. This made up an alarming 58% of CCCS clients' average monthly earning of £1,173.23 after tax.

8.1.4 The daily increase in Government national debt is £248,500,000 while the total value of all purchases made using plastic cards is £1,182,000,000 daily.

### **8.2 Types of Loans and Borrowing**

There are a number of ways in which people can borrow money for the short, medium and long term and these are often dependent on a person's credit history, employment and risk to the lender. The main ways are as follows:

#### **8.2.1 *Personal Loans***

Personal loans are more suitable for borrowing larger sums over a longer term. Costs can vary across lenders and may depend on if the loan is secured or unsecured. Secured loans are borrowed against an asset such as a home or car, meaning if the person is unable to repay the loan, the lender can sell your asset to

get its money back. You may be charged less interest on a secured loan but there may be extra fees. Unsecured Loans do not require such a guarantee but there is still a legal obligation to repay the loan. The lender can take court action to get its money back, and this could involve substantial costs and affecting a person's credit rating.

### 8.2.2 *Credit Unions*

Credit unions are owned and run by their members, for their members. Some credit unions may lend to you as soon as you become a member. Others will lend to you after you have shown them you are able to save regularly. The APR on their loans is capped by law at 26.8%, so they often charge much lower interest rates on loans than other lenders.

### 8.2.3 *Home Credit (Doorstep Lenders)*

Home credit, or doorstep loans, is where a person borrows money and the lender calls at their home to collect the repayments. The loans are usually for smaller amounts and charged at a high rate of interest for borrowing in this way. The law states that home credit lenders have to be licensed by the Office of Fair Trading (OFT). If someone is offering to lend money on the doorstep they must have a lender's licence or other authorisation, if they don't, they are operating illegally.

### 8.2.4 *Social Fund Loans*

Certain benefits entitle a person to help from the Social Fund for one-off expenses. Pay back of the loan is still required but there are no interest charges. This could be as a crisis loan to help with an emergency, a budgeting loan to help with vital costs like food and clothing or funeral payments.

### 8.2.5 *Payday Loans*

A payday loan is a cash advance lent over a short period of time, usually until the next payday. Each year some 1.2 million people in the UK resort to payday loans as a temporary means of getting by and a total of £1.2 billion is borrowed in the form of such loans every year. Taking out a payday loan is meant to be a temporary measure. Short term loans that are not paid back in time will accrue huge interest rates, and debts can quickly spiral out of control. Some of the better known payday loan companies charge interest rates of over 2,500% APR. One of the biggest attractions of the payday loan is that anyone can apply for one no matter what credit rating. For most payday loans the only eligibility criteria is to be resident in the UK, over 18 years old, have a job with a regular payday and an active bank account. Other attractions of such products are centered on the convenience and speed of the application process.

### 8.2.6 *Pawnbrokers*

Pawning is another way of borrowing money. A possession of value is left as security with the pawnbroker and in return lends money on which interest is paid. However increased use of credit cards, hire purchase, trading vouchers, credit unions etc has led to a reduction in the number of pawnbrokers. Although some still do operate and recently there has been an expansion in services such as 'Cash Converters' and 'The Money Shop' which also offer pawnbroking services. Sections 114 to 122 of the Consumer Credit Act 1974 set out the rules which pawnbrokers must obey. These regulations cover the written agreement a person is entitled to get and what will happen if a person is

unable to pay back the agreed amount within the agreed time. All pawnbrokers must be licensed by the Office of Fair Trading to operate.

#### 8.2.7 *Rent-to-Buy Retail Credit*

A hire purchase, or rent-to-buy, agreement is a mechanism for borrowing money in order to make a purchase of goods that cannot be afforded out right. A hire purchase agreement is a form of secured loan that gives the lender certain rights over the borrower by their entitlement to repossess the good in certain circumstances, until the HP agreement has been completed. Hire purchase agreements are governed by the Consumer Credit Act 1974, and the goods hired are governed by the Supply of Goods (Implied) Act 1973. Some of the biggest high-street names in this area include BrightHouse and CashConverters. With an HP agreement the goods are hired to the borrower for a specified period of time, in which the consumer will have to pay weekly or monthly payments towards the total amount payable. The total amount payable is based on the cash price of the good, plus interest over the period of agreement and any additional charges which may be levied on top. The goods remain the property of the lender until the HP agreement has been completed in full.

#### 8.2.8 *Logbook Loans*

Logbook loans are secured on a car or similar vehicle that is in the ownership of the borrower. This means that if a payment is missed, the lender may repossess the vehicle. A 'bill of sale' agreement is signed transferring ownership of the vehicle to the lender. The lender also keeps the registration documents and they own the car until the loan is paid off in full. These types of loans usually have a very high rate of interest (APR typically 300-500%) and are a very risky way to borrow money due to the fact that the lender does not require a court order to repossess the vehicle. Also if the vehicle sells for less than the amount owed on the loan, the remaining balance is still an outstanding debt.

#### 8.2.9 *Illegal Money Lending (Loan Sharks)*

Loan sharks are people who lend money without a licence from the Office of Fair Trading. Loan sharks are often well known in the community and source their customers through word of mouth. As loan sharks are not licensed they operate outside the law and are very likely to offer a loan on very bad terms with extortionate rates of interest, resort to harassment and threats of violence if a borrower gets behind with repayments and will apply pressure into borrowing more from them to repay one debt with another. It should not be underestimated that people involved in illegal money lending practices will invariably be involved in other illegal activities too.

*Example of Loan Shark Practice 1:* AF went to a loan shark when he wanted £100 to buy a car stereo that was on special offer. He agreed to pay back the entire sum several days later, and was charged £20 interest. AF, 26, of Stoke-on-Trent, had successfully borrowed money from a loan shark in the past, but on this occasion failed to pay the full amount owed on the due date, so the lender doubled the interest charge. As the debt mounted, AF found it increasingly difficult to repay the growing amounts, and missed more payments, ending up being charged £100 interest every day. Eventually the entire loan had reached £1,000 and AF was threatened with having his legs broken if he didn't pay up.

*Example of Loan Shark Practice 2:* BS, aged 22 years old, had initially borrowed just £300 but this quickly rose to £3400 over a 12 week period. During this time, BS was frequently threatened and intimidated by the loan shark and his associates; the loan shark used BS's vulnerability to charge unrealistic interest rates. On a 4 week cycle, the loan shark would lend BS money to pay off earlier debts, charging a higher interest rate each time. In just 12 weeks, his debt had gone from £300 to £3400, leaving BS helpless. The use of threats and intimidation lead BS to take his own life on 3<sup>rd</sup> December 2005.

### **8.3 Office of Fair Trading – Review into High-Cost Consumer Credit**

The Office of Fair Trading conducted a review into the high cost credit sector and published their findings in June 2010. This review was launched due to concerns that consumers of high-cost credit, including many on low incomes, suffered from a lack of options when seeking credit, that the price individuals paid for credit was too high, and that the recession had limited suppliers' willingness to lend money. The report identified the high-cost credit sector as consisting of pawnbroking, payday and other short-term small sum loans, home credit and rent-to-buy credit. The report also acknowledged that this was a significant and valuable sector in the economy with loans to consumers totalling £7.5 billion in 2008.

8.3.1 The OFT review highlighted some key features and similarities within the high-cost credit marketplace including consumers need for credit, a limited tendency to search out the most suitable product or option, lower than average levels of income, and poor or no credit history. High cost credit is expensive by its very nature and this is primarily due to the low value of the loan resulting in higher administration costs per loan, high-cost business models and the incidence of missed, late payments and bad debts.

8.3.2 The OFT also concluded that the markets for high-cost credit worked reasonably well due to a number of factors including:

- suppliers met the demand for easier access to their products;
- they filled a gap in the market not served fully by mainstream suppliers;
- the level of complaints from consumers is low, and;
- in some cases lenders show flexibility with repayment difficulties and do not penalise borrowers for missed or late payments.

8.3.3 The review also identified issues with the effectiveness of competition in these markets as follows:

- on the demand side – there is a relatively low ability for consumers to drive competition between suppliers due to their low levels of financial capability;
- on the supply side – there is a limited supply of additional sources of credit particularly from mainstream suppliers, and;
- competition on price is limited and some suppliers appear to be charging higher prices than expected.

8.3.4 The OFT review made recommendations around four major themes as follows:

- help consumers make informed decisions on high-cost credit;
- increase the ability for consumers to build up a documented credit history when using high-cost credit;

- enhance the understanding of developments in the high-cost credit sector, and;
- promote best practice among suppliers of high-cost credit.

8.3.5 The OFT ultimately concluded that, in a number of respects, these markets worked reasonably well. However, it argued that many of the problems in such markets arose from more deep-seated issues, such as weaknesses in the financial capability of consumers, and any recommendations made by the OFT would only make limited differences. The OFT also considered the case for price controls for pawnbroking, payday loans, home credit and rent-to-buy credit and concluded that such measures would not be an appropriate solution to the particular problems found in these high cost credit markets.

## **9. Recommendations**

- 9.1 That the committee agrees the title of the review as 'At Any Cost: The Effects of High-Cost Credit and Illegal Loan Sharks on Local Communities'.
- 9.2 That Members of the Management Scrutiny Committee discuss and agree the proposed timetable for the review.

## **10. Glossary of Terms**

APR (Annual Percentage Rate)  
 CCCS (Consumer Credit Counselling Service)  
 HP (Hire Purchase)  
 OFT (Office of Fair Trading)

### **Background Papers**

Credit Action – Debt Facts and Figures (July 2011)  
 Times Online – Loan sharks threatened to break my legs if I didn't pay £1,000 (7 August 2009)  
 Citizens Advice Bureau - Website  
 Office of Fair Trading - Website  
 The Money Advice Service – Website  
 Brian Shields Trust – Website  
 Office of Fair Trading – Review of High-Cost Credit (June 2010)

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