Submission to the Joint Oireachtas Committee (JOC) on Finance and Public Expenditure and Reform, and Taoiseach, concerning detailed scrutiny of the Consumer Credit (Amendment) Bill 2018

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Free Legal Advice Centres (FLAC)

November 24th, 2020

Introduction

One of the core focuses of the work of Free Legal Advice Centres (FLAC) work over many years has been monitoring legal developments and campaigning for law reform in the areas of consumer debt and credit. FLAC therefore welcomes the opportunity to make a submission on this short but important Bill and thanks the Committee for providing us with the opportunity. Despite the relatively short timeline provided, we hope that our comments will be of assistance to the Committee in its deliberations.

There are many references made in the last debate of the Dáil on this bill in December 2018 to the report prepared by the Centre for Co-operative Studies at University College Cork, UCC and published by the Social Finance Foundation (SFF) on interest rate restrictions on credit for low income borrowers.[1] That report provides wide and detailed context for consideration of this issue and concludes with a set of recommendations that merits very close attention in terms of framing this legislation.[2] Some of these recommendations will be referenced in this submission.

This is currently a one section amendment Bill but it is far from being a straightforward matter. While FLAC agrees with and supports the aim of the Bill to seek to cap the interest rate on credit agreements offered by licensed moneylenders, there are important issues that arise for discussion in terms of adopting this approach and then striking an appropriate rate. In particular, we would be concerned that unintended consequences might follow if the maximum rate chosen caused a significant number of existing licensed moneylenders to cease business and led to some people with limited credit options turning to unlicensed lenders.

In the course of this submission, a number of brief preliminary recommendations/observations are made as follows:

1. The basis for calculating APR (the Annual Percentage Rate) needs to be fully understood prior to arriving at the chosen appropriate maximum rate
2. It may be time to abolish itemising separate collection charges and factor them into the rate of interest charged.
3. The suggested maximum rate may lead some lenders to discontinue their business and the consequences of this for existing customers should be established.
4. There needs to be better enforcement practice for moneylending without a licence.
5. An assessment of the impact of the 'It Makes Sense' loan scheme would be timely
6. There should be a plan put in place to provide for alternative sources of credit for low income borrowers, should a cap lead to some moneylenders deciding not to renew their licence

[1]' Interest Rate Restrictions on Credit for Low-income Borrowers', Mary Faherty, Olive McCarthy and Noreen Byrne, Centre for Co-operative Studies, University College Cork on behalf of the Social Finance Foundation, December 2017.
[2] Ibid, see page 95

7. The State should provide access to emergency interest free loans in urgent need situations from a designated social fund and greater availability to urgent needs payments under the supplementary welfare allowance scheme
8. The Consumer Credit Act 1995 need to be amended in other respects to protect low income borrowers

Some broader recommendations that are worthy of consideration are:

9. Measures are required to deal with the wider problem of income inequality in our society that gives rise to the need for short term borrowing at high rates of interest, such as a review of the Supplementary Welfare Allowance scheme to ensure that it provides an adequate safety net, and consideration of the introduction of an evidenced based living wage
10. Apart from a maximum rate of interest for licensed moneylenders, should maximum rates for other credit providers, like banks, finance houses and sub-prime mortgage lenders be examined?
11. The forthcoming legislation to ensure that all providers of car finance – whether Hire Purchase (HP) or Personal Contract Plans (PCP) – are properly regulated should also update existing Hire Purchase legislation to take account of recent developments

Central issues

1. **Issues related to calculating APR (the annual percentage rate of charge) and choosing an appropriate maximum rate**

The UCC Report recommends (No.1) - '*Government to adopt a policy which prohibits usurious rates of interest in the interests of fairness to the most vulnerable in Irish society by the introduction of a restriction on interest rates and charges'.*

It also recommends (No.4) - *'Ensure interest rate restriction is coupled with a limit on other fees and charges and a limit on the total cost of credit, with the rules carefully designed to avoid circumvention through the introduction of other 'innovative' fees and charges'.*

- **APR and collection charges**

The Consumer Credit Act 1995, transposing the EEC Directives on consumer credit (87/102/EEC and 90/88/EEC) introduced a legislative obligation to calculate the cost of credit in credit agreements by a new mechanism called the Annual Percentage Rate of Charge (APR).

In terms of relevant definitions, *"*APR*" means the annual percentage rate of charge, being the total cost of credit to the consumer, expressed as an annual percentage of the amount of credit granted and calculated in accordance with Section 9.*

In turn, the *"*total cost of credit*" means the total cost of the credit to the consumer being all the costs, comprising interest, collection and all other charges, which the consumer <u>has to pay for the credit</u> exclusive of any sum payable as a penalty or as compensation or damages for breach of the agreement.*

Although instalment repayments on licensed moneylender's loans are often collected at the borrower's home, the borrower has a right to make payments at the business premises of the lender (see Section 103 of the CCA 1995). A moneylending agreement must explicitly state that the borrower has this option. For this reason because the borrower does not to have to pay for collection charges (see the definition of total cost of credit above), the cost of these charges is not included in the calculation of the APR. The costs of collection charges over and above rate of interest charged on the loan is therefore an important additional cost to take into account over and above any proposed maximum rates of APR.

Some lenders have dispensed with collection charges and purport not to charge any. An example is Provident Personal Credit, by far the largest licensed moneylender in this country. Its licence states its collection charges to be 0 cent, although the loans it offers are normally collected door to door. Therefore, it seems unlikely that the cost of collection is not separately factored into the rate of interest charged. (On a separate point, seeing as Provident (and other lenders) have not been able to collect payments door to door and have not had the cost of doing so since the advent of Covid 19, it might be asked whether it should providing some kind of interest rebate to borrowers as a result).

If a maximum rate of interest is to be introduced therefore, perhaps it is time to abolish itemising separate collection charges and factor them into the rate of interest charged.

- **APR and short term loans**

Provident's website currently provides two sample loan offers currently on its website for comparison purposes as follows:

- Borrow €1,000 – Repay over twelve months (52 weekly instalments) of €30 per week. Total amount to repay is €1,560. The APR is **157.3%**
- Borrow €1,000 – Repay over six months (26 weekly instalments) of €50 per week. Total amount to repay is €1,300. The APR is **187.2%**

The second loan involves paying back considerably less interest - **€300** as opposed to **€560**, but the APR is **30%** higher – **187.2%** as opposed to **157.3%.** The reason is that the term of the loan is half the length – six months as opposed to 12 months.

Were a two year loan to be offered by Provident, it would involve a considerably lower APR again, even though the total amount to be repaid would be considerably greater. But one year is the maximum period a licensed moneylender will generally lend for and many prefer six month loans or less.

As a result, the APR with these loans is always very high. On the other hand, a mortgage to be repaid to one of the pillar banks over a term of 25 years, involving the repayment of multiple thousands of euro in interest will always be in single figures, sometimes well under 5% where the interest rate is competitive.

- **APR - Is the rate suggested in the Bill appropriate?**

Is 36% APR an appropriate rate therefore?

In the Provident six month example given above, borrowing €1,000 to repay in 26 instalments of €50 per week (€1,300 in total) where the APR is 187.2%, the profit for Provident is €300 (before costs) on €1,000 loaned.

We don't have a programme to calculate APR (the Central Bank does) but mathematically it is clear that a maximum APR of 36% to repay €1,000 over six months will involve charging substantially less interest than an APR of 187.2% to repay the same amount over the same period. Were 36% APR to be the maximum that Provident (or any other moneylender) could charge by law, it might consider that the potential profit (especially after costs) that it might make would not be commercially viable for it. Indeed, a maximum APR of 36% might cause some, if not many, of the existing lenders to exit the space.

It is worth noting that the reason for selecting 36% as a maximum rate in the Bill is that it is three times the current maximum rate that credit unions can legally charge of 12% per annum simple interest (12.68% APR). However, licensed moneylenders must source their own funds whereas credit unions loans are broadly funded by the savings of their members.

2. **What are the dangers that a maximum rate will lead lenders to discontinue their business and what might the consequences of this be for customers?**

There are currently 36 licences in place (see the Central Bank of Ireland Register of licensed moneylenders at www.centralbank.ie). If a number of the existing licensed moneylenders were to cease to trade because of the introduction of a cap, what might be the consequences? For some observers, this might be considered a good thing and there are many who would like to see moneylending obliterated as a business. Some who say this, however, may fail to distinguish between a licensed moneylender and a lender operating without any licence at all and no business premises (one of the many requirements imposed under the CCA 1995 to be able to obtain a licence).

Needless to say, unlicensed lending as an unregulated practice is often a completely different story. It may often involve random and excessive repayment rates subject to change and sometimes the threat of consequences where payments are not made, as well as high levels of manipulation. However, it is unfortunately the case that people are sometimes desperate and need money in a hurry, for a wide variety of reasons, including a pure lack of money/income to pay bills, buy food, repair or replace broken appliances etc.

Unlicensed lenders (or what some call loan sharks) are active in Ireland in a number of areas. Although there are considerable (and even draconian) powers set out (in theory at least) to prosecute a wide range of offences for lending without a licence under the CCA 1995, prosecutions over the past 25 years have been very rare and more pro-active enforcement standards need to be put in place.

On this question of 'migration' to other sources of credit, The UCC report refers to the Central Bank research on moneylending of 2013 as follows:

> *When asked where they would borrow if their current moneylender ceased operating, the majority of respondents said they would either source funding from other legal sources or would no longer require credit. 24% would seek funds from another moneylender or do not know where they would source credit. This suggests that more than 75% of moneylending customers believe they have an alternative to moneylenders or would no longer require credit if their moneylender ceased operating.*[3]

It is evident from this that a substantial majority of customers of licensed moneylenders would not turn to unlicensed operators were their lender to cease business. However this may not be universal. A critical question then may be – By setting a cap at a level that there is a potential risk that licensed lenders will cease their operations, might a minority of customers who are already in

[3] Page 30

situations of poverty or financial vulnerability get into even worse predicaments, where the only perceived credit option be open to them may be cut off?

This is an important context not in deciding whether to cap the rate but in deciding what the capped rate should be. Improving access for people on low incomes to alternative sources of credit would also make a substantial difference.

3. **What is the plan to provide for alternative sources of credit, should a cap lead to some moneylenders deciding not to renew their licence?**

Credit unions are generally seen as providing the principal alternative for potential borrowers on low incomes who have limited credit options. They undoubtedly play a vitally important role across communities in Ireland in terms of providing access to financial services, both in terms of access to both savings and (social) lending services and, critically, they maintain a strong and vibrant local presence in places that the pillar banks have long abandoned.

However, there is some evidence that the credit union model does not necessarily suit the needs of all borrowers. To become a member an account must be opened with all of the documentation that this requires; the ability to borrow is based, understandably, on an assessment of capacity to repay and may also be linked to the member's savings record. For the large majority these are not onerous requirements but they are difficult for some.

Since 2018 a number of credit unions have been operating the 'It Makes Sense' loan scheme (also referred to as the Personal Micro Credit Scheme), a service directly aimed at social welfare payment recipients, and presented as an alternative to going to a moneylender (the website promoting the scheme does not distinguish between licensed and unlicensed moneylenders). As of January 2019, 111 of the country's credit unions were participating. Our understanding is that a significant number of credit unions do not operate this scheme, particularly the larger credit unions.

To apply, the applicant must be an existing credit union member or join a credit union, and the credit union assesses the application in the normal manner and has discretion to decide whether to grant a loan or not. Those applicants who receive their social welfare payment in cash must agree to sign up to the Household Budget Scheme run by An Post, whereby deductions are made at source to facilitate repayments on the loans. Those who receive their payments electronically to a credit union or bank account must facilitate repayments by standing order or direct debit. A maximum of €2,000 may be borrowed, and a minimum of €100, but it is at the discretion of each participating credit union to set its own maximum loan which will frequently be below €2,000.

As with all loans from credit unions to members, these loans are subject to a maximum interest rate of 12% simple interest per annum or 1% per month (12.68% APR). For example, a loan of €500 over six months would involve 26 weekly repayments of €19.84 amounting to a total amount repaid of €515.84, a total interest charge of €15.84, dramatically cheaper than an equivalent loan from a licensed moneylender.

These loans are clearly far cheaper but to what extent has the scheme been a success, in terms of both dissuading people from availing of the services of licensed moneylenders and providing a return to the participating credit unions? Some detail of the number and amount of loans drawn down under this scheme, an evaluation of its successes, the challenges posed and how it might be built upon would be useful. Of particular relevance might be a comparison of the perceived greater convenience of the licensed moneylender – little by way of credit assessment, home collection, the availability of more than one loan simultaneously – with the much lower cost of credit of the 'It Makes Sense' loan.

In recommending (No.3) – *'In consultation with the credit union sector, the Department of Finance consider increasing the 1% monthly cap on interest rates for credit unions as per Section 38 (1) (a) of the Credit Union Act, 1997, for this type of lending to cater for the significantly greater costs associated with such small lending'*- the UCC report envisages that the introduction of a maximum interest in licensed moneylending may lead to a reduction in the number of licence holders. It is worth noting on this question that the maximum interest rate cap for credit unions in the UK is double that of Ireland at 2% per month.

The current autumn government legislative programme document under the heading - All Other Legislation Report Autumn Session 2020 – suggests that work is underway to prepare a **'Credit Union Interest on Loans Bill'**, intended to '*increase the maximum monthly interest rate on credit union loans and to allow for that maximum rate to be adjusted in future by Ministerial Order'.* It is reported that Heads of this Bill were approved on 11th June 2019, and the Committee agreed to waive Pre-Legislative Scrutiny. Thus, it would appear that work has already begun on preparing the ground to allow credit unions to charge higher rates of interest to borrowers who may, for example, be perceived a greater credit risk.

A broader question is what the State is prepared to contribute in terms of both policy development and practical initiatives in this area, over and above encouraging credit union lending. Access to emergency interest free loans in urgent need situations from a designated social fund is one option that has been explored in the UK with limited success. It is important to emphasise that any such Fund must not replace once-off grants/payments and greater availability to urgent needs payments under the supplementary welfare allowance scheme for people in extreme short term financial difficulty to avoid the necessity to borrow should be promoted.

4. **Does the Consumer Credit Act 1995 need to be amended in other respects to protect low income borrowers**

Section 99 of the CCA 1995 provides that *'Where credit is made available to a borrower by means of a moneylending agreement that credit shall not be reduced by the moneylender or a person acting on his behalf by any amount in respect of:*

(a) repayment of the credit or any charges related thereto, or
(b) repayment of a previous credit or any charge related thereto,

and no payment in respect of the credit shall be required of the borrower by the moneylender or a person acting on his behalf before the due date of the first repayment instalment.

As well as ensuring that the full amount of any loan must be advanced, this section prohibits the practice of top-up loans, i.e. clearing an existing loan with part of the money provided under a subsequent loan, and makes this an offence. However, this section fails to go on to provide that a top-up loan will not be legally enforceable against the borrower.

In addition, although top-up loans are prohibited, there is nothing in the CCA 1995 that prohibits a lender from allowing a borrower to have multiple loans running simultaneously with that lender, as long as they are separate loans and do not involve top-ups. The implications of this in terms of payment capacity and meeting needs in the affected households are obvious and this should be revisited.

Some Broader issues

5. **What measures are envisaged to deal with the wider problem of income inequality in our society that gives rise to the need for short term borrowing at high rates of interest?**

Although this question may be outside the brief of this committee in terms of deciding whether to cap licensed moneylender's rates of interest, income inequality is an ever present context in such debates. Whilst it is often perceived that social problems like addiction are the stimulus for borrowing money at high levels of interest, in many cases it is down to simply having too little money to pay the wide range of bills that most households face.

It is also often perceived that the customers of licensed moneylenders are principally social welfare recipients who do not have access to other sources of credit, but this is not necessarily so. For example, research published in 2007[4] by the (then) Financial Regulator suggested that:

- Nearly a quarter of moneylender customers are making mortgage repayments.
- Just over a quarter of customers are servicing personal loans from another credit provider.
- The majority of customers do not worry about their debt obligations.
- The majority of customers are of the opinion that they have access to other sources of credit and are not reliant on a moneylender as the only source of credit.

Apart from inadequate levels of social welfare payments or lack of access to 'Urgent Needs Payments' under the Supplementary Welfare Allowance Scheme, low pay is also a reason why people have to borrow money to meet shortfalls. An important gap in this regard, for example, is the considerable difference between the current 'National Minimum Wage' rate, due to increase from €10.10 to €10.20 from 1 January 2021, and an 'evidence based' living wage which makes possible a minimum acceptable standard of living, currently set at €12.30 per hour.[5] The work of the Vincentian Partnership for Social Justice in this area is also of particular note, in terms of the comparisons drawn between a Minimum Essential Standard of Living (MESL) and social welfare/minimum wage scenarios for a number of household types.[6]

6. **Why a maximum rate only for licensed moneylenders, what about other credit providers, like banks, finance houses and sub-prime mortgage lenders?**

Licensed moneylenders are not the only type of credit provider that charge substantial amounts of interest in return for lending money, but they are, together with credit unions, the only type of provider for whom a maximum rate of interest is prescribed by law. In the case of each licensed moneylender, that maximum rate is the one set out in the individual licence which the lender must apply for, on an annual basis, to the Central Bank of Ireland.

Credit institutions, including banks based in other Member States passporting into Ireland on their EU banking licence, are not so constrained. Neither are sub-prime mortgage lenders who received authorisations to offer housing loans from IFSRA (now the Central Bank of Ireland) in the early 2000's without any apparent regulation of their operations and who charged almost double the going market interest rates in many instances, on the dubious basis that the borrower was a greater

[4] See Page 6, 'A Report on the Licensed Moneylending Industry', Financial Regulator, March 2007.
[5] See www.livingwage.ie.
[6] See https://www.budgeting.ie/urban-budgets/income-scenarios.html

credit risk. A number of these loans contributed and contribute to this day to the considerable mortgage arrears problem that developed in the Ireland in the wake of the Global Financial Crash (GFC).

This ground is covered in considerable detail in FLAC's 2014 Report – 'Redressing the Imbalance'. In terms of personal loans, two companies in particular entered the market during the boom years and targeted consumers on low incomes for high-cost unsecured loans. One example involves a MABS case where FLAC assistance was sought. The client, a vulnerable migrant worker, had an existing personal loan with one of these banks with almost €15,000 owed. In 2008 the Bank offered her a top-up loan to clear the existing loan, involving terms and costs that were nothing short of robbery as follows:

- Total amount of Loan **€22,777.74**
- Payment Protection Premium Advanced **€5,495.45**
- Amount of credit advanced **€17,282.29**
- Amount deducted to clear previous loan **€14,865.29**
- Net amount advanced to customer **€2,417.00**
- Number of instalments **72 (months)**
- Amount of each instalment **€561.22**
- Total amount payable **€40,407.84**
- Cost of this credit **€17,630.10**
- Annual Percentage Rate **23.4%**

Some points to note from this loan include:

- Money was lent in advance at a very high interest rate so that the client could pay for 'payment protection insurance' for the full duration of the loan. This cost €5,495.45 plus the applicable interest over 6 years.
- The existence of this insurance almost completely protected the lender from any risk associated with the loan, and yet the interest rate on the insurance and the loan was 23.5% APR, an exorbitant rate for a six-year personal loan.
- The customer received a total of only €2,417 in new funds with €14,865.29 being taken to clear the balance on the existing loan. She then would have to pay €40,407.84 or €561.22 per month for six years in return, the equivalent of a small mortgage. She was surviving on a low income at the time and no effort was made to establish her capacity to service the 'agreement'.
- There were absolutely no regulatory rules in place to prevent this happening.

Although this heading may be considered peripheral to the question of capping the rate that licensed moneylenders can charge, it is important in our view to remind regulators and policy makers alike that the market and the forces of competition does not always protect the interests of consumers and there are many other types of credit providers, apart from licensed moneylenders who could do with much closer regulation.

7. **Arising out of the recommendations of the Tutty Report, what has become of the legislation to ensure that all providers of car finance – whether Hire Purchase (HP) or Personal Contract Plans (PCP) – are properly regulated?**

On 23rd October 2019, (then) Minister for Finance and Public Expenditure and Reform, Paschal Donohoe TD, announced that he had obtained Government approval to draft legislation to provide that all firms which offer personal contract plan (PCP), hire purchase and other similar credit type agreements to consumers will be required to be authorised by the Central Bank of Ireland as retail credit firms. In this connection, he referenced the 'Tutty' report on the Personal Contract Plan market (published in November 2018) which outlined a number of recommendations to improve the level of consumer protection in relation to the provision of PCP and hire purchase agreements.

The Minister's statement suggested that the only recommendation of that report which cannot be implemented within the existing legislative framework was the key one which says that the relevant provisions of the Central Bank's Consumer Protection Code, in particular the provisions which require lenders to assess the suitability of the product for the consumer and also the ability of the borrower to repay the debt over the duration of the credit agreement, should be extended to all the providers of hire purchase/PCP agreements to consumers. This was not possible, he suggested, as some of the providers of these agreements currently fall outside the authorisation and full regulatory remit of the Central Bank, and so the Bank is not able to apply its codes to these unauthorised firms.

He went on to explain that the proposed legislation intends to address this gap and to provide that all the providers of credit type agreements to consumers and other relevant persons will now be required to be authorised by the Central Bank. Welcoming Government approval to draft the Bill, he said that "*As all the providers of PCP and other similar agreements to consumers will now have to be authorised by the Central Bank, the Bank will then be able to apply its Consumer Protection Code and its other consumer protection powers to such firms. This will improve the level of protection available to the consumers of such agreements".*[7]

The most recent government legislative programme of Autumn 2020, announced in September, includes under the heading of 'Bills that are expected to undergo Pre-Legislative Scrutiny (PLS)' a Consumer Protection (Regulation of Retail Credit Firms) Bill. This Bill is intended *'to ensure that any person or firm which provides credit, hire purchase, PCPs, consumer hire agreements to relevant persons will be required to be authorised as a 'retail credit firm' by the Central Bank unless they are already subject to such Central Bank authorisation'.* Heads of the Bill are said to be expected shortly, a hardly reassuring statement two years after the publication of the Tutty Report.

In truth, aspects of these issues have been flagged by FLAC with both the Department of Finance and the Central Bank of Ireland (CBI) for well over a decade now. Long before PCP agreements, essentially a derivative of Hire Purchase, arrived on our shores, it had been pointed out to both that providers of Hire Purchase finance that were not already regulated as credit institutions did not have to seek regulatory status with the CBI. The official justification for this positon at the time seemed to be that a Hire Purchase agreement was a rental agreement, not a credit agreement, despite the fact that thousands of euro was charged in interest on these agreements and their principal purpose was that the Hirer would acquire ownership of the vehicle.

It is interesting that the Minister's statement explains this in terms that *'some of the providers of these agreements currently fall outside the authorisation and full regulatory remit of the Central*

[7] See: https://www.gov.ie/en/press-release/ab741f-minister-donohoe-announces-government-approval-to-draft-legislation-/

Bank' almost as if this was a new realisation. In fact this has been known for a long time and it has led to situations in recent years where some garages, realising that they did not need to be regulated, took the opportunity to offer HP themselves and on their own terms. The irony then is that although hire purchase agreements themselves have been regulated since 1946, some of the providers are not.

In recent years PCP agreements have grown exponentially in Ireland and contain a number of distinctive features - Guaranteed Minimum Future Value (GMFV), significant deposits, mileage limits with potential penalties, service agreements - that are different from HP and these agreements are not specifically regulated at all, except insofar as they are considered to be HP. In addition, the first decade of the millennium saw an appreciable increase the number of hire purchase agreements and a number of new features – such as large final bullet payments and rolled over HP agreements – became common.

Again, it is interesting that the Minister's statement of October 2019 and the wording of the relevant entry in the government's Autumn 2020 legislative programme seems to suggest that this is really just about ensuring the CBI's Consumer Protection Code 2015 (CPC) applies to these agreements. In our view, it should involve much more than this, i.e. a legislative review and update of the rules relating to car finance agreements.