25th February 2014

Briefing note: Channel 4 Dispatches programme on credit reference agencies

CREDIT REFERENCE AGENCY ERRORS HIGHLIGHT NEED FOR INDEPENDENT, ACCURATE DATA

Last night's Dispatches documentary exposed the limitations of credit reference agencies (CRAs) and prompted concerns about their role in influencing payday firms' lending decisions.

Under current proposals from the Financial Conduct Authority, short-term lenders will be encouraged to share more borrower data with each other with the aim of minimising irresponsible lending to vulnerable or heavily indebted consumers. But Dispatches has highlighted the extent to which CRAs are ill-equipped for this 'regulate-by-proxy' role and provides further reasons why a regulator-owned real-time database of loan transactions is necessary.

The Dispatches programme confirmed that:

- No one CRA has a 100% accurate picture of borrowers' records because not all lenders report information to every CRA
- The main CRAs give borrowers different profiles even when based on the same information.
- CRAs' principal customers are lenders, not consumers.
- CRAs are slow to update borrowers' records, even when there are errors to correct. Routine information, such as loan repayments, are only updated monthly
- Even the biggest CRA experiences system or staff errors, which have a huge impact on consumers.

Nathan Groff from Veritec Solutions, the leading provider of regulatory credit databases, said:

"The programme raises serious questions about having a regulatory regime for consumer credit that relies on lenders freely sharing data via CRAs. Credit reference agencies have their place, and they are useful for lenders making creditworthiness assessments. But the fact remains these are commercial enterprises that act in the interests of their customers – the lenders - and their shareholders.

"If the regulator really wants to protect consumers from irresponsible lending, it needs to create and own a database that covers 100% of loans in real-time.

"These tools already exist and work effectively in other countries. It is up to the FCA to ensure British borrowers benefit from the most modern and efficient protection".

About Veritec

Veritec provides a data system that enables regulators to effectively enforce regulation of payday, doorstep and other short term consumer lending.

The company has over 10 years' experience of working with US regulators in 14 different states, covering 88 million consumers. In addition to its work in the United States, we have also advised the Provincial Governments of Ontario and British Columbia in Canada, and the Federal Government of Australia.

This briefing provides information on the high cost credit sector in the United States before highlighting developments for the sector in Australia.

Applying international solutions to the UK market

The development of the UK's high cost credit sector has followed the same trajectory as in the US with a number of US payday lenders now operating in the UK.

There are four main factors that cause consumer detriment in the high cost credit sector. These are:

- Affordability – consumers end up borrowing more than they can reasonably pay off.
- Multiple loans – consumers borrow from several lenders at the same time.
- Rolling over – consumers extend their loans indefinitely while incurring new fees every 2 to 4 weeks.
- Cycle of debt – consumers unable to pay off the extended loan that has now been increased by outstanding fees, transforming a short-term, high cost product into a long-term, extremely high cost loan.

High APRs may grab headlines but they are not in themselves a main factor in consumer harm. Indeed, all the evidence from US states that introduced APR rate caps suggests that caps are ineffective and have 'unintended consequences' of reducing consumer choice, pushing people towards loan sharks and other unlicensed operators.

There are more effective ways of regulating the high cost credit sector that protect consumers but allow for a viable short-term lending industry. These typically include setting **maximum loan amounts, banning rolling over, limiting penalty fees, and imposing cooling-off periods in between loans**.

In states that have adopted these measures, loan transaction volumes have initially declined, but lenders adapt to the changes, and actually improve their loan losses and there still remains a demand for their product.

The key factor in creating an effective system is the means of enforcing the chosen rules. Technology, like that provided by Veritec, is an essential tool that has been successfully deployed by many states to eradicate non-compliant lending behaviour.

Veritec's data system solution has been gaining traction in the UK. Most recently, **the Business, Innovation and Skills Select Committee** March 2012 report on debt management noted:

> *"It is clear that credit checking is a key factor in ensuring appropriate lending to consumers. We are therefore deeply concerned with the evidence that payday providers are not recording all of their transactions. Examples of credit databases that do capture payday lending are available in other countries and we recommend that the Government require industry to introduce similar models in the UK as a matter of urgency."*