HM Treasury

Credit union maximum interest rate cap

A Response by Credit Action

Background

Credit Action is a national financial capability charity (registered Charity in England & Wales No. 1106941) established in 1994.

Credit Action empowers people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives. It develops and delivers products and services which provide education, information and advice on money matters, in an appropriate way for young people and adults. Through its work Credit Action reaches over 500,000 UK citizens every year.

Introduction

Credit Action is committed to helping young people and adults build the skills that they need to manage money effectively, and engage successfully with the market for financial products. As part of this work, we maintain a strong interest in the needs of the most vulnerable consumers, and those who may be at risk of financial exclusion.

We recognise that credit unions play a key role in supporting these groups, and represent a crucial source of affordable finance for those who are unable to access mainstream alternatives. We are therefore highly supportive of the credit union movement. The debate over the maximum interest rate cap represents a central issue for the future of the sector, and we welcome the opportunity to contribute to this consultation.

Many of the questions in the consultation document are aimed primarily at credit unions themselves, and probe issues such as the effect that raising the cap will have on business practices, and the risks of increased levels of default. As Credit Action is not itself a credit union, it is difficult for us to comment on these sorts of questions in detail. Therefore, in setting out our position on the cap we have mainly focused on answering Question 8, and will use this relatively open question as an opportunity to put forward our views on the whether or not the cap should be raised to 3% per month. We will also make a brief comment on the legislative implications for the Consumer Credit Act in response to Question 10.

Question 8: **Considering the case for action and the potential risks, should the interest rate cap be raised to 3 per cent?**

Overall, we are in favour of raising the maximum interest rate cap to 3% per month, and feel that this strikes the right balance between ensuring the viability of the sector on one hand and the needs of customers on the other.

Given the findings of the DWP's *Feasibility Study*, we accept that increasing the cap is essential to building the long-term sustainability of the sector, which is vital not just for credit unions themselves but also their clients. We also note the points made in paragraphs 3.2 and 3.3 of the consultation, which ascribe the high unit costs faced by credit unions when providing loans to two main factors – the cost of giving financial advice to borrowers, and the cost of accepting small, regular, over the counter repayments. As a financial capability charity we are particularly aware of the importance of credit unions' financial advice function, and the value that this type of support can hold for customers. We also see credit unions' capacity to accept small, regular repayments as a central part of their appeal to consumers who may be managing on a low-income. Consequently, we feel that it is essential that both of these aspects of the service are preserved, and that raising the cap in order to enable credit unions to cover the high costs of these activities would therefore be justified.

If the cap is to be increased, then raising it to 3% per month would appear to be the most sensible approach, based on the analysis of the options put forward in Chapter 2. We agree with the point made in paragraph 2.4 that requiring credit unions to comply with the terms of the Consumer Credit

Act, which would be one consequence of abolishing the cap altogether, is undesirable as it would place significant additional administrative burdens on credit unions which would likely be passed on to borrowers in the form of higher interest rates.

Equally, we are sensitive to the fact that maintaining the cap but increasing it above the current 2% per month limit will unavoidably impact on borrowers to some extent, and therefore believe that that the level of the rise should be not be unduly excessive. Given that, as outlined in paragraph 2.5, the DWP's *Feasibility Study* found that setting the cap at 3% per month would be sufficient to enable credit unions to operate on a stable basis, we agree that this level of rise is appropriate.

However, as increasing the cap will inherently make some loans more difficult to repay, we would emphasise the importance of ensuring that sufficient support is available to those who do encounter difficulties under the new regime. Measures such as extending the repayment period in order to make repayment more manageable, which is mentioned in paragraph 4.5, would in our opinion be very constructive, and more broadly we would simply encourage Government and the sector to make sure that the options available to help those who struggle to repay are appropriate.

Question 10: Are there any risks related to raising the CCA exemption limit?

Given our support for the proposal to raise the maximum interest rate cap to 3% per month, the main point that we would make with respect to the CCA exemption limit is to acknowledge the necessity of raising the total charge for credit level to 42.6% in order ensure credit unions remain exempt from additional regulatory burdens, as outlined in paragraphs 5.4 to 5.6.

Contact

For further information on any of the points made in this response, please contact John Davies at Credit Action, either by email at johndavies@creditaction.org.uk or by telephone on 0207 380 3390.