



## **REFORM OF CONSUMER CREDIT LAW - OUTDATED LAW HITTING CONSUMER FINANCE**

### **FLA BRIEFING**

1. FLA (Finance & Leasing Association) urges speedy reform of the outdated 66-year-old consumer credit law on “voluntary terminations” – better known as the “Half Rule” - which is costing the motor industry £83 million annually.
2. FLA, principal representative of the asset, motor and consumer finance sector in the UK, believes the Half Rule distorts the credit market and results in businesses and consumers paying higher rates of interest on credit agreements while people in real need of protection – such as those in financial difficulty – lose out.
3. Manufacturers, financiers and leasing companies all back the need for reform. The Bar Council can find no justification for keeping the Half Rule, which dates back to the 1930's.<sup>1</sup>

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<sup>1</sup> Response Of The Law Reform Committee Of The General Council Of The Bar To The Consultation On Voluntary Termination Of Hire Purchase And Conditional Sale Agreements Under The Consumer Credit Act 1974

### The need for reform

4. The effect of sections 99 and 100 of the Consumer Credit Act 1974 or the “Half Rule” is to give a borrower under a hire-purchase (HP) or conditional sale (CS) agreement the ability to hand back a car at any point in an agreement but only be liable for one half of the total price.
  
5. HP is a mainstay of affordable, fixed rate, fixed term borrowing which is accessible to the majority of people. It provides additional protections such as innocent purchaser protection, connected lender liability and gives the customer the benefits of ownership. In an independent<sup>2</sup> analysis of FLA members in 2004 on the impact of the Half Rule (summarised below) it was found that FLA members account for £25.1 billion of outstandings, of which around £17.6 billion was written as HP.
  
6. In September 2004, DTI published a consultation paper on the Half Rule. Whilst deciding that, on balance, changes to the Half Rule were inappropriate at that time, options for reform were considered.
  
7. One of these options was to amend the current law to allow creditors to recover a higher proportion of the amount remaining due under HP and CS agreements, whilst continuing to give consumers protection. Increasing the Half Rule to 75%, would, the Government estimated, produce a balance at “about the right level to eliminate the losses lenders say they are making at present”. The consumer’s rights to settle the agreement under the early settlement provisions will remain unaffected and those rules, which have recently been re-designed to ensure greater fairness.

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<sup>2</sup> OXERA Consulting Ltd Report “What is the likely impact of abolishing the VT provisions” November 2004

8. We believe that the law should be changed to give effect to this option. Reform is long overdue.

#### Why the law should be changed

9. The Half Rule is used in today's market to such an extent that it leads to heavy annual losses for HP providers. In 2003 this amounted to £83 million. As higher value cars and other products sold on HP become regulated, the situation will deteriorate further. Losses are estimated £91.3 million when the new Consumer Credit Act 2006 is in force. This is an unintended consequence of the legislation, designed with a very different market in mind. Losses vary from one provider to another. They vary according to the behaviour of the customer, the nature of the vehicle and the policies of the dealerships. The Half Rule disregards any principle of fair recovery. To HP providers recovery under the Half Rule is truly a lottery.
10. The Half Rule is regarded by some as a protection for those in financial difficulty. But in the last three years, 80-90% of consumers using it have not been behind in their payments. It is, however, used by dealers to encourage car sales and leads to massive and unpredictable losses for HP providers.
11. The Half Rule has never been without its critics. The potential for unfairness for *both* lenders and consumers was recognised widely from its inception. At the time of its introduction in 1930's, it was regarded as a crude and imperfect measure. It applied to a wide variety of goods such as jewellery and radiograms but crucially, was used very seldom.
12. The car market was in its infancy when the Half Rule was devised, but is now worth in excess of £65 billion<sup>3</sup>.
13. The impact of the Half Rule also distorts the competitive aspects of the market as between one HP provider and another and between HP providers and loan companies. In addition, there are further distortions in the availability of HP as a

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<sup>3</sup> Source RMI: In 2003, the total expenditure on cars through retailers

product in both the motor and other markets particularly as levels of VTs increase. HP is seriously threatened as a viable instrument by abuse of the Half Rule. No equivalent measure exists in other EU Member States.

### Summary of research

14. FLA commissioned independent research group, Oxera, to report on the impact of the Half Rule. The results are summarized as follows:

- Only a minority of consumers who use the Half Rule are in financial difficulty (10%).
- There has been a distortion of competition between HP/CS agreements and other consumer finance products as a result of steps taken by credit providers to limit future Half Rule losses. These steps include restriction of credit provided via HP/CS agreements, increasing deposits and shortening the length of such agreements.
- Restriction of HP/CS agreements impacts particularly on consumers with low incomes and contributes to financial exclusion.
- Abolition of the Half Rule would eliminate distortion of competition and lower the cost of HP/CS credit for consumers and increase its availability.
- Furthermore, SMEs would benefit by gaining access to HP finance which is currently not offered by leading credit providers on assets such as IT and office equipment because of the Half Rule.

### Conclusion

15. HP is a relatively straightforward product, generally understood and trusted by consumers. It provides cheap consumer finance.
16. VTs are bad for consumers as a whole. They over-inflate new car sales and have an artificially negative effect on used car prices.
17. Failure to grasp the opportunity to modernise the law now would continue to distort the market, inflate prices and lets down consumers generally.

If you would like to discuss this issue further, please contact:

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