National Audit Office

Office of Fair Trading

Regulating consumer credit

Technical paper

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Contents

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Introduction

1 This technical paper accompanies the publication of the National Audit Office's value for money report, *Regulating Consumer Credit*, published in December 2012. The report assesses the effectiveness of the OFT's regulation of consumer credit markets in minimising consumer harm.

2 To assess value for money of the OFT's regulation of consumer credit we looked at how harm operates in consumer credit markets, the levels of harm that exist, and how effective the OFT has been in minimising consumer harm.

3 This paper includes:

- Our extensive literature review of how harm operates in consumer credit markets (Part One).
- A discussion of the data and methodology we used to quantify the levels of harm and the effectiveness of the OFT's regulatory actions (Part Two).
- Results from our analysis on the financial impact of the OFT's regulatory action (Part Three).

Part One

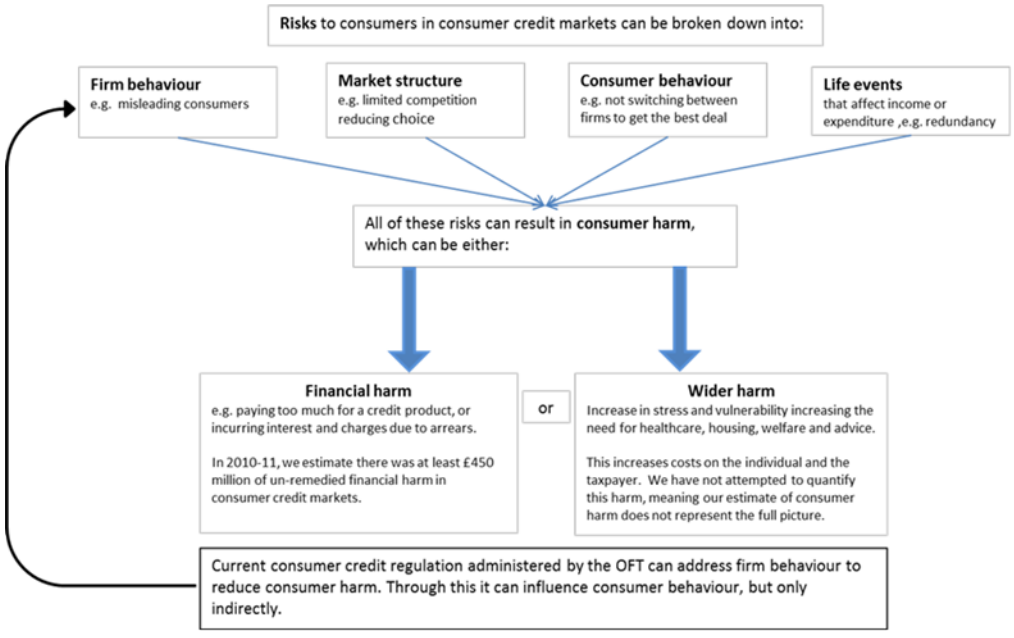
Consumer Harm review

1.1 The UK has one of the highest levels of consumer credit as a proportion of GDP in the EU, standing at over 15 per cent in 2008. Many consumers use credit products as part of the everyday management of their finances without running into any difficulties. However, for others, consumers can be at risk of experiencing harm.

1.2 **Figure 1** shows the four main risks that lead to consumer harm: firm behaviour, market structure, consumer behaviour, and life events. This harm can be either financial or wider harm. This part of the paper looks at how these risks operate in more detail.

Figure 1

The relationship between risks, consumer harm and regulation in consumer credit markets



Source: National Audit Office analysis of consumer harm

How consumer harm operates

Firm behaviour

Lack of affordability checking

1.3 Under the Consumer Credit Act (the Act), lenders have to conduct affordability checks in order to ensure consumers can meet repayments and be able to maintain a reasonable household expenditure. The OFT set out expectations for this in their Irresponsible Lending guidance. How robustly affordability checks are conducted varies throughout the consumer credit markets.

1.4 Consumers often access payday loans from several companies which lead them into a cycle of borrowing and leave them unable to pay back their existing debt. The levels of affordability checking vary from lender to lender and on some occasions no repeated affordability checks are completed when additional loans, often of increasing amounts, are taken out.

1.5 The lack of affordability checking is exacerbated by the lack of information sharing between credit providers. For example, not all home or payday lenders share information with credit agencies despite consumers using multiple suppliers. This issue was addressed in the home lending market investigation (Competition Commission, 2006). Following the investigation, any provider with 60 or more agents or more than £2 million turnover has to provide full data on all new credit agreements to at least two credit reference agencies.

Incentive based selling

1.6 There is the potential in the credit market for there to be incentives for firms to sell products leading to consumers being lent money irresponsibly. There is an incentive for credit brokers, who can act as a retail distribution channel for lenders, to offer products to borrowers that may not be best suited to their needs because they are paid on a commission basis. Credit brokers may also have an incentive to overinflate the credit worthiness of a borrower to a lender so that the loan is more likely to be approved. This could lead to consumers being granted loans that they actually cannot afford.

1.7 Investigations into debt management companies (DMCs) have highlighted that some were offering high commissions to financial advisers who pushed a client into more expensive debt solutions. Which? has highlighted the practice of front-loading of fees where the DMC will ensure that fees are paid first before they start paying the customer's debt (Which?, 2011). This lengthens the time the customer is in debt.

1.8 Some payday lenders were found to be actively encouraging customers to rollover their loan despite the industry's claim that one of its main benefits is the short-term nature of the loan. The StepChange Debt Charity reported that the average amount of payday lending debt owed by their clients was £1,267 (CCCS, 2011). This is far higher than the average payday loan of £275.

Advertising

1.9 Advertising also has a major effect on consumer decision making and there is evidence that some advertising focuses on consumers' limitations. The Act outlines how firms should go about advertising and in 2008 the OFT brought out guidance to explain in more detail this section of the Act.

1.10 Research has highlighted how consumers find the ease and convenience of high-cost credit as a major reason for using this type of credit and perhaps unsurprisingly advertising for high-cost credit has tended to focus on the accessibility of getting credit (e.g. through direct mailshots about pre-approved loans). Which? found that some payday loans adverts were even encouraging consumers to take out a payday loan to fund a holiday or a luxury purchase.

Switching

1.11 Switching is low in consumer credit markets. This allows companies to offer teaser rates to entice consumers and raise the costs when consumers are tied in. Low levels of switching have been found in the home lending market. In this market, the information asymmetry that exists between an existing lender and a new entrant makes switching less likely because of the emphasis on keeping existing customers. This drives prices down for existing customers rather than new ones so they are less likely to switch to a new lender. There is very little substitutability in the home credit market which further reduces the competitive threat to home lenders.

Market structure

1.12 While there are relatively low barriers for credit firms to enter the market, there are a few sector specific problems. In the home credit market, for example, there is a barrier to entry in terms of economies of local density, meaning that in order to compete with larger home lenders a new entrant would need to have a large local field force of agents.

1.13 There may also be barriers to prevent some firms already in the consumer credit market providing different products. One of the main reasons cited by mainstream financial services firms for why they do not enter the high-cost credit market is the stigma attached to the market and the potential reputational damage of being associated with this type of credit.

1.14 Agreements between lenders and brokers may limit consumer choice. Lenders may form links with brokers and use exclusivity agreements thereby preventing consumers deciding between credit options, for example when a point of sale broker such as a car dealership is tied to single credit provider. Alternatively, brokers may only source products from a limited selection of lenders which therefore may result in consumers being offering non-competitive credit deals.

1.15 In 2004 the OFT referred the home lending market for investigation by the Competition Commission. Recommendations were made for greater price transparency and a decreased level of information asymmetry. One of the ways of doing this was by publishing prices on a comparison website funded by the largest providers and generally providing better, clearer information.

1.16 For some short term loans the APR is not the most suitable way to compare costs and the total cost of the loan is more suitable. Additional charges that can be placed on credit, for example missed payment charges, may increase the cost of credit and can make comparison between products even more complicated. Research conducted by Which? has found that it was almost impossible to compare loans on a like-for-like basis. This was because not all companies calculated interest in the same way and also that the high penalty charges were not adequately explained.

1.17 For some consumers seeking a loan for a short period high-cost credit may be appropriate, however, if the repayments cannot be made on time this may result in the cost of credit being much higher than the consumer originally anticipated. It has been estimated that low income credit users are exposed to approximately £340m in overdraft fees per year, at an average of £176 each and it is estimated that 30 per cent of the 1.3 million low income credit card users have also incurred fees due to late or missed payments (Ellison *et al*, 2011).

1.18 Research conducted by Which? found that consumers looked at six key features when choosing a credit card (Which?, 2007). The problem that Which? found was that because there was no one single feature that a consumer looked at, and the fact that companies would provide different types of information, it was very difficult for consumers to compare across credit cards.

Consumer behaviour

Rules of thumb

1.19 One of the major reasons consumers choose to take out credit is a major change in their financial situation, either an employment change or a change in their domestic situation. Additionally, once consumers have the information they often use decision making short-cuts or ‘rules of thumb’, to help them choose between competing products. These factors combined may have an impact on consumers' capability to decide which credit product is the most suitable.

1.20 A further cause of consumer harm we found centres on how consumers look for the best value in obtaining credit. OFT (2010) estimated that if consumers shopped around for the best deal within the high-cost credit market, they could save up to £120 million (made up of £80,000 for pawn broking, £21 million for payday lending and £99 million for home credit). OFT acknowledged that this was only a partial estimate and that the true figure could lie somewhere between zero and £120 million.

Over confidence

1.21 Consumer overconfidence in their circumstances can result in consumers ignoring some choices or in some cases simply deciding not to make a choice at all. For example, as some consumers tend to be overly confident about their ability to pay off credit card debts on time they generally don't look at the cost of missing payments. This has led to cards pricing structures which generally under-price short-term costs and over-price long term costs such as charges for missed payments.

1.22 Another example of consumers' overconfidence is the fact that they generally do not think they will need to access additional funds either by borrowing money on credit cards or using their overdraft function. This overconfidence means they are much less likely to compare the price of borrowing money from different card providers or compare overdraft prices thus reducing the need for these companies to compete on price.

1.23 Research suggests these financial penalties were one of the main causes of consumer detriment. Ellison *et al.* (2011) found that annually, 3.6 million low-income consumers experience financial penalties whilst using mainstream credit, which amount to approximately £630 million at an average of £174 per head.

Life events

1.24 Past research has identified a number of risk factors that could cause consumers to end up in financial difficulty. A change in circumstance (e.g. birth of a child, being made redundant, relationship breakdown) for many people would be enough to tip them into financial difficulty and cause them to miss payments on existing credit agreements often resulting in penalty charges.

1.25 The sudden strain put on finances by these changes in circumstances can lead to many consumers turning to consumer credit products in order to smooth over variations in their income.

Regulating to minimise harm

1.26 The Office of Fair Trading regulates consumer credit to protect consumers from harm that arises from either the deliberate or accidental mistreatment by credit providers. As demonstrated in Figure 1, if not remedied, mistreatment can result in consumers incurring financial harm, experiencing undue stress, and, in severe cases, can have a wider negative impact such as an increased demand for healthcare.

1.27 In assessing the value for money of the OFT's regulation of consumer credit market we quantified the amount of financial harm in consumer credit markets, as well as the amount of financial harm that has been avoided through the OFT's regulatory actions. The remainder of this paper describes the data sources and methods we used to do this, and a discussion of the results.

Part Two

Data

2.1 We carried out the analysis using data from two main sources: Consumer Direct complaints database and OFT's Case Management System.

Consumer Direct (CD) database

2.2 Consumer complaints data is a very useful source of information on the prevalence and nature of consumer harm. Consumer Direct was launched in 2004 by the then Department of Trade and Industry, working with Trading Standards Services, as a telephone complaints and consumer advice service. This service was subsequently taken over by the Office of Fair Trading in 2006. In April 2012 responsibility for delivering consumer advice and information passed to Citizens Advice and Citizens Advice Scotland. Prior to 2004, individual Trading Standards Services dealt with complaints and queries directly and all data was held locally, meaning that it could not be aggregated and was, therefore, of limited use for intelligence purposes. The Consumer Direct database brought consumer complaints and enquiries information received by Consumer Direct into a single database which can be interrogated by a wide range of users.

2.3 Complaints data have been described as the "gold standard" of indicators on detecting consumer harm (OECD, 2010). However there are some limitations to these data that need to be acknowledged:

- Complaints may not be valid.
- There will be no complaints for problems of which consumers are unaware.
- The complaints will be limited to consumers who know where and how to make a complaint.
- Those who complain will represent only a subset of consumers who considered it worth their time and effort to lodge a complaint.

Whilst very little can be done about the first two limitations, we addressed the third and fourth limitations by using a multiplier from previous OFT research to scale up the number of complaints recorded in the CD database to reflect the actual level of consumer harm. This is discussed further in the methodology section.

OFT Case Management System (CMS)

2.4 All the OFT's investigation and enforcement cases are recorded in the Case Management System (CMS). This database contains important information, such as the name of the company being investigated, when the case was opened and closed, the source that triggered the investigation and the outcome of the investigation. However, our analysis of the database shows that is it often incomplete and inconsistent. For example, for some cases the date closed is missing, although the case has already been closed; or the source that triggered investigation and outcome have not been recorded. Another important shortcoming of the CMS is that consumer credit enforcement cases cannot be easily separated from other enforcement cases, such as Enterprise Act cases. Despite the limitations, however, CMS is the best source of data available at the time of conducting our analysis.

Methodology

2.5 In order to estimate the impact of OFT interventions we constructed a partial cost-benefit model in Excel using cost estimates described below and matching data from the Consumer Direct database and OFT's Case Management System to derive the benefits from the OFT's actions. We call it 'partial analysis' as it is focused only on the financial harm experienced by consumers as a result of firm behaviour and does not include financial harm occurring due to other factors (e.g. market structure) and wider harm to the consumer and to the whole economy, as illustrated in Figure 1.

Cost estimation

2.6 In order to conduct cost-benefit analysis of enforcement activities, we required detailed cost information for different types of these activities. The OFT does not do activity-based tracking that would allow easily to establish the costs for each enforcement case. Furthermore, OFT does not know how much cases resulting in different outcomes cost. For example, there is no information on whether the case resulting in advice is cheaper than that resulting in warning or whether licence application investigations are more expensive than compliance enforcement actions against existing licence holders.

2.7 We therefore employed a bottom-up approach to cost estimation to establish the average cost for an enforcement action. This approach, also known as process-based costing, involves establishing distinct steps in the process, estimating the costs of each step and then combining costs of all steps to produce one total estimate, including the appropriate share of overhead costs. We also produced cost estimates for different types of case outcomes, such as advice, warning, undertakings, revocation, etc.

Enforcement staff costs per case

2.8 We conducted a workshop with some of the OFT's enforcement officers to map the investigations and enforcement processes. When the process map was created, the officers helped to establish staff grades and effort time it would take to complete each task in the process and the probabilities of the case going through different paths. The process map and probabilities were later agreed with the Head of Enforcement at a separate meeting.

2.9 Using data on OFT staff pay scales, we calculated wage per hour for each grade using the formula:

$$Wage\ per\ Hour = (Average\ Salary)/(250 * 7.2)$$

where 250 is the assumed number of working days per year for public sector staff and 7.2 is the average number of working hours per day.

2.10 Knowing how many staff members of each grade are involved in each task, we then used hourly wage for each grade to cost each task in the process map:

$$\begin{aligned} &Average\ Cost\ per\ Task \\ &\quad = Sum\ of\ Staff\ Cost\ per\ Hour * Hours\ spent\ on\ the\ task \\ &\quad * Probability\ of\ Case\ going\ through\ this\ task \end{aligned}$$

Average enforcement staff costs per case were calculated by adding up the costs of all tasks.

Trading Standards costs per case

2.11 When the OFT's enforcement team receives a case for investigation, it may decide that a visit to the trader premises is required. As a London-based organisation it is often more cost effective for the OFT to ask the Trading Standards Service (TSS) to make a visit on its behalf. OFT estimates that about 90 per cent of cases where a visit is required are undertaken by the TSS. The TSS charges OFT £68 per hour (plus VAT) for each visit and the average hours per visit are 13, which brings the total cost per visit to £1,054. The average TSS cost per case is calculated by multiplying the total costs per visit by the percentage of cases where a visit is required.

Legal and Adjudication costs per case

2.12 Some investigations and enforcement cases require input from lawyers and adjudicators at different stages of the investigation. According to the OFT's management accounts, in 2011-12 there were £1,013,470 of legal and adjudication costs in the Consumer Credit Group. OFT noted that legal and adjudication teams do not spend 100 per cent of their time on current cases, but are also involved in non-case related activities, such as policy development, corporate responsibilities, etc. To reflect this fact we multiplied total legal and adjudication costs of £1,013,470 by 0.85[1] to arrive to £861,450. The OFT has also provided us with the information on which categories of cases require legal and adjudication input. We apportioned the total legal and adjudication costs based on this breakdown.

Overhead costs per case

2.13 According to the OFT's management accounts, in 2011-12 financial year there were about £4.3 million of Overhead costs in Consumer Credit Group. We have apportioned these costs based on the proportion of FTEs that work in the Consumer Credit Group's (CCG) enforcement team, 55 people, compared to the FTEs in the whole CCG, 124 people and 620 new investigation and enforcement cases opened in 2011-12.

Total costs per case

2.14 Therefore, from these costs per case explained above we calculated the total average costs per case. This is the sum of average enforcement staff costs per case, average trading standards costs per case, average overheads costs per case and average legal and adjudication costs per case. Results of this costing exercise are presented in Part Three.

Benefits calculation

2.15 The objective of this analysis is to estimate the impact of the OFT's consumer credit enforcement activity in 2010-11, and how this can be monetised to derive a partial cost-benefit ratio. To do this, we counted the volume of complaints generated by a sample of companies subject to OFT action; comparing the count of complaints in the 365 days before a case had been closed on each company by the OFT with the count for the 365 days afterwards. We compared the difference between these two counts to what might otherwise have happened by modelling a counterfactual scenario based on a control group of companies featured in the Consumer Direct database who were not subject to OFT action in 2010-11. The following sections provide a step-by-step account of our method.

[1] OFT suggested that legal and adjudication teams spend about 80 to 90 per cent of their time on current cases. We took an average of 85 per cent.

Constructing the treatment and control groups

2.16 We focused our analysis on companies subject to OFT investigation and enforcement action that had at least one complaint recorded against them in CD database 365 days before and 365 days after the OFT took action in 2010-11. This was to ensure that these companies would be comparable to those featured in the CD database - which by definition had recorded at least one complaint. There were 54 companies that matched these criteria. These companies formed our treatment group.

2.17 Using the CD database of complaints relating to consumer credit in 2010-11, we created two control groups to model the percentage change in year-on-year complaints that might be expected in a group with similar characteristics to the treatment group.

2.18 To derive both control groups, we first reduced the total database of 27,633 complaints in the CD database to isolate as far as possible the unique company names. For each of the resulting 7,622 companies, we then randomly chose a complaint made in 2010-11, and counted the number of complaints in the CD database 365 days before and after that complaint. We then stratified complaints for these companies received in the 365 days before according to two criteria:

- Type of product or service being complained about (e.g. credit cards, debt collection)
- Type of behaviour being complained about (e.g. harassment, bogus selling)

2.19 We repeated the exercise of counting complaints made and stratifying them with the OFT treatment group. The only difference between these exercises was that the date at which the 365 day periods projected from was not randomly chosen, but was instead the case close date for the case involving that company from the CMS.

2.20 The composition of companies in the first control group was chosen so that, for the 365 days prior to the reference complaint, the average number of complaints per company about each particular product or service code (e.g. credit cards) was as similar as possible to the same average observed in the treatment group. After having removed companies which also featured in the treatment group, the effect of this exercise was to reduce the original 7,622 companies to 300 companies that produced a sufficient similarity of average complaints per company to the treatment group.

2.21 Companies in the second control group were chosen so that, for the 365 days prior to the reference complaint, the average number of complaints per company about particular behaviours in the group (e.g. harassment) was as similar as possible to the average number of complaints about the same behaviours in the treatment group. After having removed companies which also featured in the treatment group, the effect of this exercise was to reduce the original 7,622 companies to 329 companies that produced sufficient similarity of average complaints per company to the treatment group.

Estimating complaints averted by OFT enforcement action

2.22 The percentage change in complaints in the 365 days after, relative to the 365 days before was calculated for each control group, with the following results:

- Control group A (Type of product): a 0.6% decrease in complaints
- Control group B (Type of behaviour): a 0.4% increase in complaints
- We took the average of these two percentage changes (i.e. - 0.1%), to be the year-on-year percentage change which would have occurred in the volume of complaints for the OFT treatment group in the following year, if these companies had not been subject to OFT action.

2.23 To estimate the impact of OFT action in reducing complaints, we generated a counterfactual, 365-days-after count for complaints in the treatment group by reducing the 365-days-before count by 0.1%. We then subtracted this figure from the actual 365-days-after count which was observed from the CD Database in order to derive an estimate for the net volume of CD complaints averted, which came to 381.

2.24 There is evidence that suggests that not all people who experienced harm would complain, either because they do not know where and how to complain or they considered that it is not worth their time and effort to lodge a complaint. Indeed, OFT research (2009) suggests that the CD database under-reports true number of complaints, and that the multiplier for these complaints is sector specific. For professional and financial services, a multiplier of 59.3 is estimated by the OFT. This implies that the true number of complaints averted by the OFT treatment group cases is higher, at around 22,600.

Calculating Assumed Consumer Detriment (ACD)

2.25 The CD database records payment amounts involved in transactions which complaints relate to. This allowed us to estimate an average figure for Assumed Consumer Detriment (ACD) per complaint averted to apply to our figure for averted complaints.

2.26 We were unable to observe the payment values of the averted complaints directly. We therefore assumed that an averted complaint from a particular company could be represented by a random pick from a lognormal distribution with the same mean and standard deviation to the sample of payment values recorded in the Consumer Direct database, for that company, over the period 2009-10 to 2011-12.

2.27 We created a simple Excel model consisting of cells programmed to calculate the value of each company's averted complaints by modelling them as random picks from their respective distribution. The number of cells for a given company was equal in each case to the reduction in year-on-year complaints for that company. Over 1,000 trials in which the value of each cell was free to vary according to the distribution it was drawn from, we recorded 1,000 times the average payment value of the cells for all companies which had experienced a reduction in complaints for the OFT group.

2.28 Recognising that sample variation in each company's complaints means that the true average payment value for the averted complaints is likely to lie between a range of values, we used statistics from the 1,000 trials to generate a plausible range. Our central estimate was taken to be the average of the 1,000 recorded values for average complaint. The high and low values were assumed to be the 95th percentile and the 5th percentile, respectively. This gave a range of £1,040 and £1,430 between which 90 per cent of our modelled figures for the average payment value for averted complaints lay. Our central figure for average payment value was £1,220.

2.29 OFT research (2009) suggests that the value of Assumed Consumer Detriment is lower than the average recorded values from the Consumer Direct database. In order to calculate the average assumed consumer detriment per complaint, we used a log-linear formula suggested by this research:

$$Log_{10}(D) = 0.3354 + 0.6340 Log_{10}(P),$$

where D is the assumed consumer detriment and P is the average payment value. This formula can be inverted to return an estimate for average ACD, given a figure for average payment amount. Applying this formula to our ranged estimates for payment value, we estimate the average ACD for an averted complaint from our treatment group to be in the range of £180 to £220, with a central figure of £200.

Monetising the impact of cases in the treatment group

2.30 To estimate the range of the financial impact of cases in the OFT treatment group, we applied the maximum and minimum values for ACD to the estimate of 22,600 Consumer Direct complaints averted. This gave a range of financial impact of £4.0m to £4.9m, with a central case of £4.4m.

2.31 The cost to OFT of the enforcement actions against the 54 companies acted upon was estimated using the data on unit cost derived in the bottom-up costing exercise described above. The costs were assigned to each case depending on the outcome of the OFT's action against those companies (e.g. revocation). Total costs for the cases in the OFT treatment group were estimated as £0.5m.

2.32 We report the benefit-cost ratio of the cases in the treatment group as a range, in which the lower bound was derived as the ratio of benefits to costs using the low scenario average payment value, and in which the upper bound was derived as the ratio of benefits to costs using the high average payment value.

Part Three

Main results

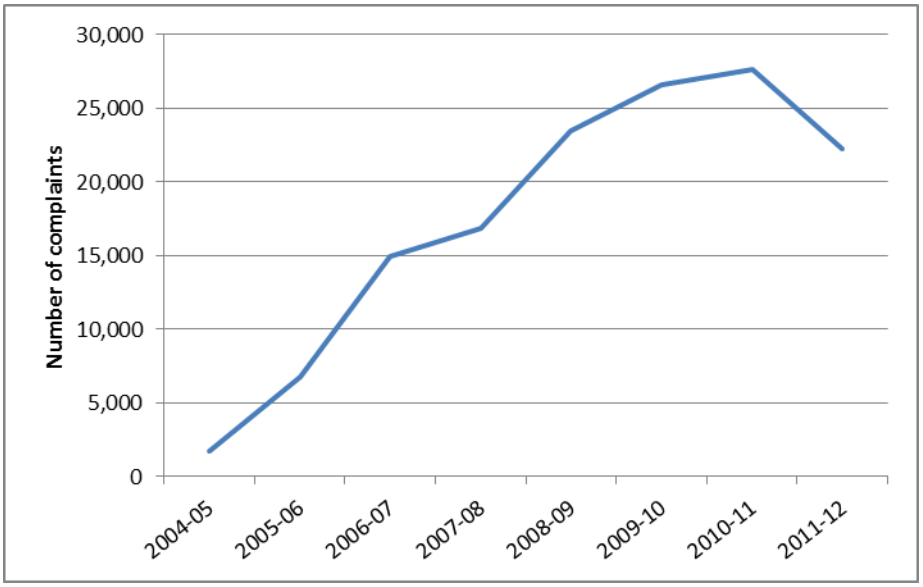
Descriptive data analysis

Consumer Direct (CD)

3.1 The Consumer Direct complaints data were available for eight years, from 2004-05 to 2011-12. We analysed the trend of complaints for this period. **Figure 2** suggests that the number of complaints has risen considerably between 2004-05 and 2010-11. This might be due to a number of factors. The rapid growth in consumer credit market until 2010 might have led to higher number of unscrupulous lending practices that generated larger number of complaints. Consumers might also have become more educated and their awareness of where and how to complain has improved.

Figure 2

Total number of consumer complaints about credit products



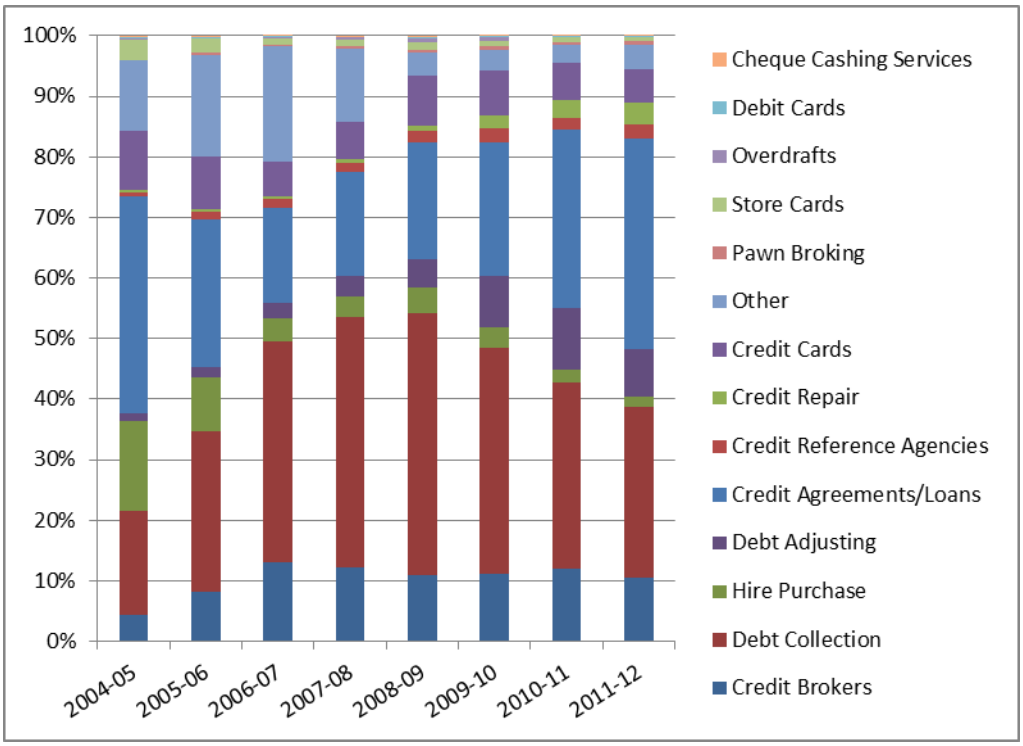
Source: National Audit Office analysis of Consumer Direct data

3.2 Between 2010-11 and 2011-12, however, the number of complaints has fallen substantially from about 28,000 to about 22,000 complaints, a 21 per cent reduction. There is evidence that consumer credit market is shrinking from 2010 (PwC, 2011), which could have resulted in the drop in the number of complaints.

3.3 We also analysed the breakdown of complaints by type of credit products for 2004-05 to 2011-12. **Figure 3** below shows that a proportion of complaints was related to debt collection and credit agreements/loans. The main two reasons for complaints about these products were unfair business practices and substandard services.

Figure 3

Consumer complaints by type of credit product



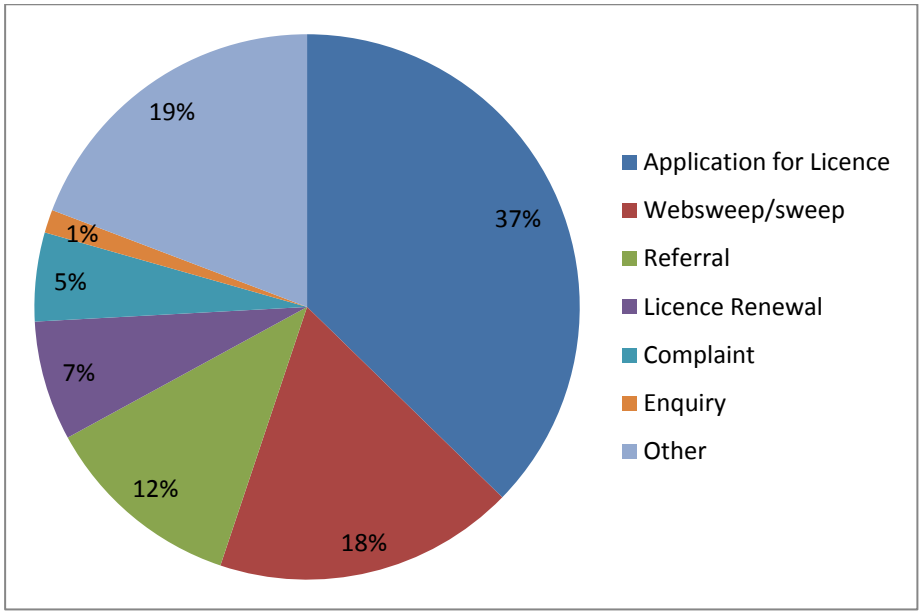
Source: National Audit Office of Consumer Direct data

Case Management System

3.4 We had access to the OFT's Case Management System (CMS) database from 2004-05 to 2011-12. According to the CMS, 620 investigations and enforcement cases were opened and 655[2] cases closed in 2011-12. **Figure 4** provides a breakdown of opened cases by case trigger type. Over a third of investigation and enforcement cases were triggered by the new applications for licenses, while the other two thirds were cases relating to the compliance of existing licence holders.

Figure 4

Breakdown of cases opened in 2011-12 by case trigger type



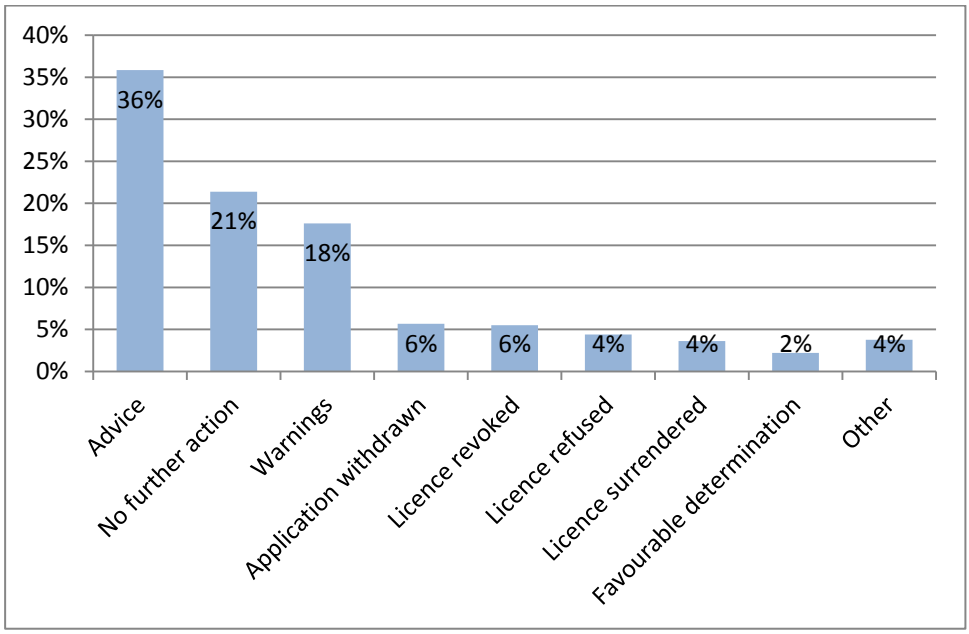
Source: National Audit Office analysis of CMS database

[2] This number covers all cases irrespective of the year they have been opened

3.5 **Figure 5** breaks down cases closed in 2011-12 by the type of outcome. More than half of cases opened in 2011-12 resulted in informal action by the OFT: 36 per cent advice and 18 per cent warnings. At the same time, 21 per cent of cases have resulted in no action being taken by the OFT.

Figure 5

Breakdown of cases closed in 2011-12 by type of outcome



Source: National Audit Office analysis of CMS database

Cost estimates

3.6 The results obtained from our 'bottom-up' approach to cost estimation are presented in **Figure 6,** which shows unit costs and total costs for all cases in 2011-12. We estimate that the average total cost per case is £7,327. Multiplying this cost by the total number of cases opened in CMS in 2011-12, which is 620, gives us the total case costs of about £4.5million. The enforcement actions at £9,924 per case are more expensive to OFT than the licence investigations at £6,832 per case.

Figure 6

Consumer credit enforcement cost estimates

Cost type	Amount
Input costs	
Average enforcement team staff cost per case	£2,484.02
Average Trading Standards cost per case	£378.10
Average legal cost per case	£1,389.44
Average overheads cost per case	£3,074.89
Calculated unit costs	
Average total cost per case for licence investigations	£6,831.45
Average total cost per case for enforcement actions	£9,923.50
Average total cost per case for all cases	£7,326.45
Total costs to the OFT of investigation and enforcement	
Total case costs in 2011-12	£4,542,396

NOTE

1. Total case costs are calculated by multiplying the number of cases opened in 2011-12, which is 620, by the average total cost per case of £7,326.45

Source: National Audit Office analysis

3.7 We also estimated the costs of cases resulted in different outcomes. The results in **Figure 7** overleaf indicate that licence revocation is the most expensive outcome, while the least expensive one is the granting of the licence. This is not surprising given that revocation of the licence requires substantial legal and adjudication teams' input. In the cases where after initial investigation, no evidence against a firm was found by the OFT, the licence would be granted and the cost to the OFT would be low.

Figure 7

Cost estimates by type of outcome, £

Outcome	Average Staff Cost	Including Overheads	Total including legal
Revocation	14,087	33,669	38,623
Legal action short of revocation	13,258	31,688	33,714
Undertakings	12,565	30,031	32,519
Dismissal	5,033	12,030	14,518
Discontinued	2,484	5,937	8,425
Referral	2,484	5,937	8,425
Withdrawn	2,484	5,937	7,445
Advice	1,786	4,269	4,522
Warning	1,513	3,616	5,642
Application refused	1,490	3,562	8,515
Licence varied	1,490	3,562	6,050
Licence granted	858	2,050	2,557

Source: National Audit Office analysis

Cost-benefit analysis of consumer credit regulation

3.8 Cost-benefit analysis aims to quantify in monetary terms all societal costs and benefits of a programme or project, and thus establish whether it represents value for money compared with alternative uses of funding. We conducted a partial cost-benefit analysis focusing only on costs to the OFT, and the Assumed Consumer Detriment involved in the estimated reduction of complaints about companies in the year after OFT enforcement action was concluded against them. This was restricted to a sample of 54 cases which closed in 2010-11.

3.9 Based on our analysis, we found that the £509,902 spent on the 54 company cases in our sample in 2010-11 resulted over the following year in £4,407,587 of benefits. This represents a benefit-cost ratio of 8.6:1.

3.10 We recognise that this ratio is subject to uncertainty resulting from the unobserved nature of the complaints averted. Our analysis suggests that within plausible ranges for average payment value, the BCR is likely to lie between 7.8 and 9.6 to one (**Figure 8**).

3.11 These results assume that unreported complaints generated using the multiplier of 59.3 are associated with the same average Assumed Consumer Detriment as those measured using actual Consumer Direct data. This is a strong assumption, as it is possible that the reason for not reporting complaints might be that the financial loss involved is too negligible to make the effort to complaint. Figure 8 shows the effect on the BCR if, on average, the average payment value of these unreported complaints was worth only 50% as much as the averted complaints which would have been reported.

Figure 8

Estimated Benefit:Cost Ratio[1] of OFT enforcement action in 2010-11

Scenario	Low Case	Central Case	High Case
Unreported complaints worth 100% of reported ones[2]	7.8	8.6	9.6
Unreported complaints worth 50% of reported ones[2]	4.0	4.4	4.9

NOTES

1. For a sample of 54 cases closed in 2010-11
2. Unreported complaints refer to those assumed to exist using the OFT's (2009) multiplier of 59.3

Source: National Audit Office analysis

3.12 Our results hinge crucially on the causal link between OFT action taken against companies and subsequent reductions in complaints. We have not proved this causal link rigorously, but have rather attempted to construct robust control groups and compare the outcomes of the same analysis on both treatment and control groups. Although the difference in the year-on-year growth between the two types of groups provides some evidence of the additional impact of the OFT, it is possible that some of the reduction in complaints may be the result of factors beyond OFT's control, such as downsizing in the high-street banks, or action by other regulators such as the Financial Services Authority. We have not attempted to quantify the reduction in complaints attributable to these factors, as this was outside the scope of this work. We however recognise that the benefits from OFT enforcement action might be potentially overstated. We should also acknowledge that there is a possibility that complaints in the short term may increase as a result of OFT actions, as more consumers may become aware of a problem and seek redress.

3.13 However, it is also possible that our analysis underestimates the benefits from OFT actions. It provides no account of financial harm occurring due to other factors (e.g. market structure), or other types of harm such as emotional harm which may have occurred as a result of the behaviour of companies in our sample. It should also be noted that this analysis have only focused on the impact of direct investigation and enforcement actions recorded in the OFT's Case Management System on complaints. We recognise that OFT's Consumer Credit Group has also other means of regulating the industry, for example by issuing guidance. This may potentially play an important role in preventing consumer harm.

3.14 Another important limitation of this analysis is that we estimated the benefits accrued only one year after OFT have taken action. Clearly, the benefits to OFT enforcement action in terms of the deterrent effect could last longer than one year. We did not quantify benefits further than one year, because this increased the risk of falsely attributing reductions in complaints to OFT, when this was actually due to other factors.

Financial harm by type of credit product

3.15 The data available have also enabled us to estimate the value of potential harm that is not currently addressed by the OFT's regulation. Following the methodology described in Part Two, we have calculated the value of total Assumed Consumer Detriment for each type of consumer credit product in 2010-11. **Figure 9** overleaf breaks down the ACD by type of product.

3.16 Figure 9 indicates that the total un-remedied financial harm in the market is at least £450m. Over half the total harm in 2010-11 occurred in the credit agreements and loans market, and about a quarter in the debt collection and debt adjusting markets. Therefore, we conclude that although the OFT is getting a good return for the money spent on consumer credit regulation, enforcement action is not yet minimising consumer harm.

Figure 9

Total Assumed Consumer Detriment by type of credit product, 2010-11

Consumer Credit product/service	Assumed Consumer Detriment, £	Per cent
Credit Agreements/Loans	263,987,342	58.7
Debt Collection	85,039,610	18.9
Debt Adjusting	26,422,704	5.9
Hire Purchase	22,791,065	5.1
Credit Brokers	16,163,642	3.6
Credit Cards	14,770,666	3.3
Credit Repair	7,393,844	1.6
Credit Reference Agencies	1,542,601	0.4
Pawnbroking	1,141,872	0.3
Store Cards	565,368	0.1
Debit Cards	219,554	0.05
Cheque Cashing Services	187,562	0.04
Overdrafts	38,715	0.01
Other types	9,077,723	2.0
TOTAL	**449,342,269**	**100**

Source: National Audit Office analysis

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