HOUSE OF COMMONS

TREASURY COMMITTEE

Banking Crisis - Consumer Issues

Wednesday 14 January 2009

MR DOUG TAYLOR, MR PETER TUTTON and MR ANDREW CAVE

MR MICHAEL COOGAN, MR STEPHEN SKLAROFF and MS ANGELA KNIGHT

Oral Evidence

Taken before the Treasury Committee

on Wednesday 14 January 2009

Members present

John McFall, in the Chair

Nick Ainger

Mr Graham Brady

Mr Michael Fallon

Ms Sally Keeble

Mr Andrew Love

John Mann

John Thurso

Mr Mark Todd

Sir Peter Viggers

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Witnesses: Mr Doug Taylor, Personal Finances Campaign Manager, Which?, Mr Peter Tutton, Senior Policy Officer, Citizens Advice, and Mr Andrew Cave, Head of Policy, Federation of Small Businesses, gave evidence.

Q114 Chairman: Welcome to this, the second session of our Banking Crisis Inquiry, and we are looking particularly into the consumer issues. Can you introduce yourselves for the shorthand\writer, please, starting with Andrew?

Mr Cave: Andrew Cave; I am the Head of Policy at the Federation of Small Businesses.

Mr Tutton: I am Peter Tutton; I am a social policy officer at Citizens Advice.

Mr Taylor: I am Doug Taylor; I am the Personal Finance Campaign Manager at Which?

Q115 Chairman: Good afternoon; thank you for coming. Doug, maybe a question to you first. Falling interest rates, we are told, do not benefit savers and there has been a big issue of that over the past few weeks. What will be the impact in those sections that are heavily reliant on their savings income do you think?

Mr Taylor: It is clear that the banks have wanted to have their cake and eat it recently by passing on the base rate cuts to savers but not necessarily passing the benefits of that to borrowers. We found in November that 92% of banks had passed on their cut and instant access accounts had fallen 2% in the last year and notice accounts had dropped 3%. Perhaps to illustrate what the impact can be, there is now a cash ISA with 1% interest which means that somebody saving up to £3000 in that account would have interest paid in the year of £3 (sic), which would not be subject to tax but is nevertheless a relatively small amount, so the impact can be great. I suspect the impact is greatest on those people who are most reliant on savings for their pension, so people who have fairly substantial amounts of money is where that effect will be significant and they will probably be forced into a situation of eating into their capital. I think the reality is that for borrowers, who tend to have a larger amount, the impact can be substantially greater, and by not passing on some of the benefits to borrowers we have seen some particular difficulties for people on standard variable rates.

Q116 Chairman: What can the Government do, Peter, to have a better balance between the different interests of savers and borrowers? Is there anything the Government can do?

Mr Tutton: It is very difficult. Our main concern is obviously with borrowers and people with arrears problems - we do not see very many savers at the moment at Citizens' Advice, we tend to see people who have no money. Our concern about Government action there is really about ensuring that people are helped as much as possible if they get into difficulty. That may be about ensuring rate cuts but it may be about doing other things as well. We see the package of help for borrowers from the Government; we will need to see how that works, we will need to see how the forbearance parts of that work, and maybe the Government's role there can also be ensuring that lenders do what they can to help by forbearance when borrowers are in difficulty. That is our main priority.

Q117 Chairman: Doug, in terms of mortgage arrears you are quoted as saying that the FSA "is fiddling while Rome burns" and should be naming and shaming companies that are not treating customers who have mortgage arrears fairly. How widespread is that phenomenon?

Mr Taylor: That particular quote was taken on the basis of the FSA's paper that it issued on consumer responsibility and it was about where we thought they should be putting most of their energy, so it was around things in the market that might be a difficulty.

Q118 Chairman: It was not based on any practical evidence?

Mr Taylor: The FSA themselves when they have looked at the market have found in their thematic work on mortgages significant problems in the past about the information that companies had held on the way that mortgages had been sold, and they found particular problems about issues around those mortgages which had gone into the securitised areas, so particularly sub-prime and buy-to-let. There is some evidence in that area that the FSA needs to be extremely vigilant about the situation and ensure that the best practice which the best lenders are following is more universally adopted throughout the market.

Q119 Chairman: I wonder how many of them come through your door at the end of the day; Peter, if you can give us a view on that and maybe add to that the fact that many of the problems in the US market came from its fractured methods of selling mortgages. To what extent do you think that the current mortgage crisis in the UK reflects a failure on the part of mortgage advisers rather than banks?

Mr Tutton: In part is the answer to that. We have two different things with mortgages. Since the credit crunch or where it started to accelerate quite markedly we started to see growing numbers of people getting into difficulties from 2005 onwards and in many of those cases what we were seeing is people would come in and they were being given, in some cases, loans that were unaffordable from the start - in particularly the right to buy sector people were finding difficulty with the first payment - and more generally lots of evidence of people who looked like they could afford it on paper but the reality was that very quickly they were getting into difficulty, disproportionately from sub-prime lenders as well. That is an intermediated market as well, so what we found when we talked to borrowers was that they were listening to the advice and what they were being told by financial advisers - people were saying yes you can afford this, they were taking that. In terms of regulation we probably have not seen quite the same as in the States, what the FSA has set up has had some effect, I guess, but it has not been wholly successful. We have certainly seen some cases of irresponsible lending, cases where borrowers have not had their vulnerability to debt properly pointed out to them, where advisers seem interested in selling loans rather than really checking affordability, where lenders in some cases have not really looked hard at what was going on with advisers. That certainly had a part in the build-up of problems that we saw increase - in 2005/06 we were seeing a 10% increase a year in arrears problems; when the credit crunch started to hit in around the autumn of 2007 what happened was that we saw an immediate increase in arrears which was about all these vulnerabilities, people who were really struggling, it did not take much to put them over the edge. I think a bit of that was a failure of regulation.

Chairman: Thank you very much. Nick.

Q120 Nick Ainger: I was contacted in December by a family from Cambridge who had received a letter from Abbey, their mortgage provider, saying that they had done a quarterly review of the value of their property and as properties in the area had fallen quite substantially their 90% loan-to-value ratio was now exceeded and that they required the mortgage-holder to basically pay the difference within three months to bring them back within the 90% threshold. I contacted Abbey and they said that they had no intention of invoking this clause, but I then questioned them as to why they had sent the letter in the first place. Is this common practice? Have you heard of any similar cases and do you not think that given the circumstances the industry faces at the moment if there are existing clauses they should all be revoked rather than an assurance being given that they will not invoke them?

Mr Tutton: We have not seen evidence of that nature but if we did we would be extremely concerned about it, people being put in that position after the event, an actual change by lenders that is very detrimental. We would be very concerned but we are not seeing evidence of that at the moment; but we will keep a sharp lookout for it.

Q121 Nick Ainger: In terms of those people who do find themselves in a situation where, because of the fall in the value of property, when they are coming to the end of a fixed term loan they are faced with far higher rates because they are in excess of the 90% loan-to-value ratio, what do you think can be done to actually help these people who are faced with that type of situation through no fault of their own?

Mr Tutton: It is a difficult one. Our main concern with this and where we are seeing it at its worst is in the sub-prime sector where there are people who cannot remortgage because that market just does not exist at the moment so they are just stranded there. Helping them is going to be difficult; obviously, again, it goes back to what I said before in that we really need these lenders to show forbearance. If people are struggling to make the payments we would expect lenders to think what other ways are there around that, can they defer payments until maybe the market picks up. There are specific things, if people have lost their jobs, like the standard interest rate payment - we have recently seen the Government has made reforms to ISME which are very welcome but that will not necessarily help, we might find people who are stranded on rates very much higher above the standard interest rate so the Government might want to think about moving that to help people. There are a few practical things, but it is a very difficult problem.

Q122 Nick Ainger: Do you not think the actual mortgage lender has also got a share in this as well? There are two parties to this and they both share risk, and to penalise someone because the value of all houses has fallen, do you not think that that actually is unfair and they should actually be renewing or providing a new mortgage at the same rates and they bear the same sort of risk as the mortgage-holder?

Mr Tutton: It all sounds fair enough to me. There is a problem, as I say, particularly with what we saw with the sub-prime market and where you have discounted periods. They then end and people get stranded; it is a recipe for disaster. I agree with you that that is something that needs to be looked at if the market comes back, particularly with more vulnerable borrowers. We have seen a lot of people where their payments jump up and they cannot go anywhere else, so it is bound to go wrong. I kind of agree with you as to how that gets worked out.

Mr Taylor: This is going to become an increasing problem if house prices fall by another 15% because you will end up with 1.5 million households in this particular situation because the standard variable rate, which is where they will move to, is so much higher. They will find that not only will they be paying more money but you are potentially into this issue about increasing repossessions. It is a very significant issue and at least part of the solution must be in the way that those lenders handle customers who are in financial difficulties.

Q123 Nick Ainger: You mentioned repossessions: Shelter in its submission to us has suggested that the law on mortgages needs to be reformed to protect borrowers and they are objecting to the ability of lenders to force a sale based on only two months of arrears. They are also objecting to the application of foreclosure which means that all the sale proceeds, regardless of the size of the original debt, revert to the lender. Do you agree that those are two issues particularly that need to be reformed?

Mr Tutton: Yes. There was a recent case where this happened which caused a lot of panic. On the good side the FSA and CML have both given statements saying this is an unfair practice if lenders are doing this. We would agree with Shelter, we think the law needs to be looked at again to make it absolutely clear that borrowers are always getting the protection of the courts. The Ministry of Justice are conducting a review into mortgage law and we think that is one of the things they need to look at.

Q124 Nick Ainger: Are there any other issues on which you think the law on mortgages should be reformed?

Mr Tutton: We are just thinking through this at the moment and maybe it is one thing we could get back to you on. We can look at things like what are the powers of the courts when people come before them; the court takes a snapshot: can you pay at that time. Those powers have been more or less the same for 20 or 30 years; is there a case now for courts to have more flexible power to give borrowers more time? We have seen, for instance, the government two-year deferral but not necessarily all lenders will play ball with that, so if there are lenders that will not do the courts need more powers? That would be one thing that we would look at, the powers of courts to help people; making sure that people have the protection of the court and that lenders cannot sidestep that would also be important.

Nick Ainger: On the package which the Chancellor announced in the Pre-Budget Report, part of that package was that there should be no enforcement action until at least three months had elapsed while the borrower was in arrears. Is it enforceable?

Q125 Chairman: Could you give us a quick answer because I want to move on?

Mr Tutton: Yes, the pre-action protocol should make that enforceable.

Q126 Nick Ainger: It is enforceable in your view?

Mr Tutton: The pre-action protocol has come in; if that is an industry standard and it is not being agreed to, CML guidance is if they say that is not agreed to then the courts should be throwing those cases out.

Q127 Ms Keeble: I wanted to ask a bit about credit cards and store cards which obviously are responsible for quite a lot of consumer debt and so on. Doug, you advise people against taking out loans on store cards; could you just say why?

Mr Taylor: The APR on store cards is invariably higher than the APR on credit cards and credit cards often have other potential benefits to them such as section 75 of the Consumer Credit Act, so by and large the deal that a consumer will get on a credit card is better than the deal they will get on a store card. If somebody wants to use a store card in order to access a special discount that is one thing, but to use the store card as a means of borrowing money is not a sensible course of action.

Q128 Ms Keeble: Certainly during the boom in retail spending we saw an enormous amount of credit being provided through store cards. Do you see any sign that any of the providers have actually brought their practice into line, because we still hear of some quite extraordinary promotional deals on local radio and so on, and what kind of interest rates do you see them now charging?

Mr Taylor: The average APR I believe on store cards is about 24%.

Q129 Ms Keeble: Average.

Mr Taylor: Yes. We have no evidence of this but I imagine that staff are incentivised in the sale of store cards. I can only speak anecdotally from my Christmas shopping where I was offered several times a store card.

Q130 Ms Keeble: I probably had the same experience as well.

Mr Taylor: That would be my response to that.

Q131 Ms Keeble: Are there any companies that you think are good or any that you think really need to improve their practice because some, I have to say, look like financial services with bits of furniture attached.

Mr Taylor: We have just taken a very straight and simple approach to this and that is a credit card is better than a store card, so we have not looked at the market company by company and tried to identify best buys so to speak, we have taken a very simple and straightforward approach on this one.

Q132 Ms Keeble: There have obviously been the reports about Amex and their 46%; what is behind that?

Mr Taylor: It seems an enormous amount of interest to charge on that particular product and clearly they go for a niche market. I do not know what their thinking was on that but it does not seem a very sensible proposition for anybody to take that particular card.

Q133 Ms Keeble: Just on store cards - and Peter has probably got some experience on this as well - do you think that the pressures imposed on people as a result of buying with store cards are properly recognised? Should the regulation be more integrated with financial services and do you think this is something that needs to be looked at in terms of when companies collapse - for example MFI had about 30,000 customers with various amounts of purchases and bills and so on outstanding. What do you think we should be looking at there?

Mr Tutton: There are a number of different issues with store cards and we are clearly keen that people are not left in any difficulty by the collapse of firms - we were very concerned about Farepak for instance - so that people lose money. More generally on store cards, they are regulated products and we would be keen to see how well store cards are sold.

Q134 Ms Keeble: Is there any monitoring currently or not?

Mr Tutton: This is always of course the thing with regulation; they are regulated under the Consumer Credit Act and the Consumer Credit Directive will also probably pick them up, but in terms of sales practice what actual oversight is there? I guess the other point on APRs is of course that two or three years ago it went all the way through the Competition Commission who made an order on store cards, so this is a matter that has already been the subject of an extensive investigation. If there are still problems there maybe there is also a point on, as I understand it, the

Competition Commission has one shot at doing things and I do not know how good its ability is to come back and look at things again if market conditions change and there is still a problem, or if the remedies have not been successful in completely rooting out the problems. So there is another question there about once something has been through, can they come back again and deal with a problem further on.

Q135 Ms Keeble: Have you been surprised by the continued promotion of store cards and do you think that that is building up some more pressures on people in terms of them taking out loans or taking out excess credit which they simply cannot afford given the financial pressures building here?

Mr Tutton: It is a tricky one. We are obviously always concerned about the way that credit is marketed and we think the way that credit is marketed of course needs to be responsible, that borrowers need to have the risk properly pointed out to them and we are concerned that if anyone takes out credit they should be helped as much as possible to understand the consequences, how vulnerable they are, so that people understand can I afford this, what is the interest rate, what is it going to cost me? The problem is that at the point of sale in the shop do you get that time to think about it? On the one hand that the things are being promoted is not in itself a problem if that promotion is responsible and borrowers are properly helped to decide what they are getting into. Our worry is that these are very quick sales of credit agreements, how well are the staff trained, how well are the borrowers informed; that is the worry.

Q136 Ms Keeble: What evidence do you have?

Mr Tutton: We constantly get evidence about people with store cards who do not know necessarily what they are taking out, people who think they are taking a loyalty card or something and then are shocked when they get a bill - they do not really understand what is going on; they do not understand the agreement. Our clients tend to have low levels of financial capability, often on low incomes and quite vulnerable, and do not necessarily understand where they are coming out, so there is a need for more training, a need for sales staff, a need for people to understand better the tools for borrowers to understand. It also brings us into the whole area of financial capability and how do we get consumers to better understand the products that they are getting.

Ms Keeble: Thank you.

Q137 John Thurso: Andrew Cave, can I perhaps address this question to you: your December 2008 poll of small businesses set out pretty graphically the kind of difficulty that SMEs are having with regard to both access to finance and to the increasing cost of that. Has there been any improvement since then, are you seeing anything coming through, or is it continuing to deteriorate?

Mr Cave: We do not have any polling data to compare with the polling that we did in December so I would not like to say that we can prove that it is deteriorating or it is the same, but the figures that came out from the BBA yesterday do demonstrate to us that overdrafts have reduced by £100 million in October and November and small businesses are having to dip into their savings to the tune of £900 million. These figures again are for October and November but the anecdotal evidence that we receive from members on a day to day basis suggests that the problems are continuing, and if you look at the survey data from December the most startling result from that was that in answer to the question if this situation continues what will be the situation, 41% said that they would consider curbing hiring and 39% said that they would consider closing their businesses, so it is quite a distressing time out there for our members.

Q138 John Thurso: The Government made some announcements in the PBR and, perhaps more importantly, made quite a lot of announcements yesterday and eventually brought them to Parliament today. Have you had an opportunity to look at that and what impact do you think those announcements will make?

Mr Cave: Of the announcements today the key one is obviously the £1.3 billion finance scheme for small businesses, which we welcome. We proposed a very similar scheme last October and it is important to point out that since last October when it was first proposed to now over 6,000 businesses have closed their doors, so we would have liked to have seen this come on tap much sooner. However, it is better late than never and we believe that it will make a real difference. When you actually look at the criteria as long as the banks actually follow through with this, and this is the key question now ---

Q139 John Thurso: Do you have a concern on that?

Mr Cave: Yes, we do.

Q140 John Thurso: Can you identify it?

Mr Cave: The issue of confidence is a really big problem for our members and the phone calls that we are having already today off the back of this morning's announcement is "What is the point in this because it is still going to be delivered through the banks?" I do not share that view 100% because the fact that it is guaranteed 75% by the Government should start to give confidence back to banks and more importantly branch managers at the grass roots level to think yes, this is okay, we can take this risk. There has been a lot of talk about whether £1 billion is enough; in our view this is a stimulus, this is a measure that needs to stimulate confidence both on the side of business but also in banks as well and demonstrate to banks that they can lend to small businesses during a downturn, viable small businesses, and hopefully that will free up other lending.

Q141 John Thurso: The problem with the Small Firms Loan Guarantee Scheme in many parts of the country has not been that the scheme is not there but that the banks simply did not want to implement it. This scheme is very much based on the same levels of criteria; is not the danger therefore that it will suffer the same problem?

Mr Cave: The criteria have been broadened out, also the fee associated with it is 1.5%, with the SFLG it was higher, but coming back to your last point and this one as well, our concern about the delivery is whether banks will be promoting it, whether they will use it as a facility, so as an organisation we are now moving into the next phase of our campaign to make our members aware of this. We have a bank watch programme that we launched last year and we will be watching very closely the behaviour of the banks across the country at grassroots level to pick out this behavioural inconsistency where they say at national level they are going to make use of this fund, but they do not at grassroots level, so we will be picking up on that.

Q142 John Thurso: My next question was going to be are there regional differences in the impact of what the banks are doing being felt by SMEs; is that data you have or is it data you are going to collect over the coming year?

Mr Cave: We will be collecting that over the coming year. We already have anecdotal evidence and case studies that demonstrate that there are huge behavioural inconsistencies. I do not know whether it is by region but, for example, we had a small business come to us recently who had been told by their bank manager that the European Investment Bank money could not be offered at a preferential rate. That is simply not the case. We took that to the senior managers in the bank concerned and they said "We will look into that." There are a huge number of these cases that crop up and we obviously need to iron those out, but a lot of it comes from the fact that there is fear on both sides of the fence. Small business owners are scared to go and talk to their bank mangers at the moment and really they should be going and talking to them more than before, but equally bank managers are scared of making a bad decision or the risk of making a bad decision and, hopefully, the announcement today will bring back a bit more confidence to that relationship.

John Thurso: Thank you.

Q143 Chairman: I had a business breakfast in my constituency on Friday morning and there were about 80 businesses there. There was quite a bit of anecdotal evidence and if I could distil it, it would be that businesses were saying that behind the scenes there are changes to their arrangements - for example, arrangement fees that cost them a lot, overdraft facilities being withdrawn or the charges increased, and in fact I had quite a big business this morning that said to me that they were approaching their bank to change their covenants but the bank now want a fee to discuss the change in their covenants. Does that strike a chord with you?

Mr Cave: Very much so. This is something that we first picked up on last October but we are getting case studies of examples of that happening now. For example, one member in Wales had been banking with this bank for 30 years and millions of pounds had been going in and out of her bank, she had a very viable business, no problems whatsoever on the horizon. The bank decided that they were going to change her loan into an overdraft and they were going to charge her an arrangement fee, and that arrangement fee when you added it up added up to £100,000. I could keep going; there are a lot of examples there.

Q144 Chairman: That is good; maybe if you could share that type of evidence with us it would be good.

Mr Cave: Yes, we will do.

Chairman: Thanks very much. John Mann.

Q145 John Mann: Thank you, Chairman. In November 2006 the Competition Commission decried the lack of competition in the home credit market; is lack of competition when we are dealing with the poor and the sub-prime market the problem?

Mr Tutton: It is a difficult one really. It is partly about lack of choices for credit, it is partly about people on low income having to use credit for basic essentials which perhaps should come from somebody else, so people are going to a home credit provider maybe because they cannot get access to something like the Social Fund. There are a number of different problems and there are other problems across the sub-prime market which broaden out more to things like sub-prime mortgages and so on, and problems about practices as well. So it is partly about competition and I think the issue of competition that we see in some problem areas is that it is not really about the market structure, it is about the practices of firms and what firms do. They may be allowed to do that within the market structure but, as you say, regulators can stop them doing it.

Q146 John Mann: If you have a poor credit rating then you are going to pay more despite the fact that you are poorer.

Mr Tutton: Yes.

Q147 John Mann: Doubtless you would say that is wrong.

Mr Tutton: Yes.

Q148 John Mann: What should be done about it precisely?

Mr Tutton: Again, it is a very difficult thing. We could say that instead of home credit, lending to some of the poorest people, are there alternatives like the Social Fund, so that where people are being forced to use credit at high rates of interest for essential items, should that happen - it could be for household items where in the past that would have been something that may have been helped through the benefits system. We are obviously supportive of the Government's moves for financial inclusion, to try and encourage things like credit unions and alternative lenders that are cheaper; that is something else that can be done. With home credit it is a difficult one; the Competition Commission found that it was expensive and there was some excess profit but not as much excess profit as some people would have said because of the cost of collection, so if you can get the cost of collection down it might help.

Q149 John Mann: You have a whole section of the community there and I could give you countless examples where someone knocks on the door or rings them up or writes to them and tries to get them to, say, buy their council house at a discounted rate, fills in what the savings will be, then goes in and under a different name but the same individual then sells them a secure loan because there is plenty of equity because they have a discount on the initial council house sale. Then they have also got perhaps a credit card or a couple of unsecured loans and they then get targeted and targeted and end up paying more and more and more. You are saying competition is part of the answer; the Consumers' Association says it more strongly, you say it throughout your submission: competition, competition, have you not become rather part of the problem?

Mr Taylor: In looking for a market solution to issues, clearly in the banking sector they are profit maximisers and that is their objective. It may well be that if society wants to create a different way of dealing with difficulties then that social policy objective has got to be met through government intervention.

Q150 John Mann: Are we not in a bit of a different situation now because other consumers are having to pay for those consumers in the sub-prime market who are not actually paying back. We are in a different economic situation; that is now better recognised than it was in November 2006. Should you not be changing your tack, you are the biggest consumer organisation in Europe, should you not be coming to us with specifics, not on more competition for this market of the poor but how there can be sensible lending and how that can be encouraged, be it through regulation or be it through other means.

Mr Taylor: We do try and intervene in the work of bodies such as the OFT which is currently looking at the issue of responsible lending and we will seek to assist those regulatory bodies in order to make sure that the most effective system is in place.

Q151 John Mann: But your submission is encouraging more and more competition, more and more different companies, more and more people who will knock on the door of my constituents. Is that the solution, or is not the solution in fact more effective regulation so that there is less competition, there are less doorstep lenders who are better controlled, better understood and would that not allow some of my constituents to in fact make a more informed consumer decision?

Mr Taylor: That may or may not be the case, we have simply taken a view on how we could best ---

Q152 John Mann: You are the biggest consumer organisation in Europe; are you a consumer organisation for the informed middle class, electronically astute consumer - which are some of my constituents of course, and all this Committee - or should you not actually be facing up - and the CAB as well at the sharp end of this - to actually coming to us with more formidable proposals about what should be done that would protect the position of the most vulnerable consumer who in fact is costing all other consumers because of what is going on?

Mr Tutton: On looking at some things like sub-prime mortgages we have argued long and hard. We did a big report in December 2007 where we argued very strongly, but the problem that we were seeing in the market was about bad practices, bad selling practices, and the regulators out there need to do more about it. We consistently argued that the OFT need to be more on the case with regulating lending practices, so yes we would agree. We have argued for years that there need to be tougher rules about irresponsible lending and controls on the way that lenders go to consumers; it is something we have argued again and again and again, so I agree that to an extent competition is important but there are certain issues which are classed as competition issues - for example, PPI went to the Competition Commission but it is actually a fair trading issue, not a competition issue. That is about remedies and it is about the way regulators work, it is not about us. We have argued for a long time that you need to make that point to the regulators.

Mr Taylor: We will come back when we have a solution to any problem which we have researched and believe is robust; we would not want to come up with something that was half-cocked and therefore what we come up with is what we think is robust.

Chairman: Crisply put. Andy.

Q153 Mr Love: In the written evidence that Which? submitted to the Committee you draw out the conflicts of interest that are faced by those banks and financial institutions over the significant injection of public money; on the one hand you say that they remain commercial enterprises but that because of the amount of public money they have received they should have a specific duty to the wider public interest. Does that wider public interest mean that they ought not to be commercially driven?

Mr Taylor: The Government has made clear that they are institutions that have a commercial remit. If we take them in two different tranches, if we take Northern Rock for example which is fully nationalised, then there has been an incentivisation of the staff to get off the books a high level of mortgages, and I think it has gone down by £13 billion. The consequences of that are that they have the highest record of repossessions, so they can be a commercial organisation without necessarily running rampant against the interests of their borrowers. If we look at some of the more recently partially nationalised banks and the Lloyds/HBOS deal, we do think there are some public interest issues here and we would certainly like to see them to be exemplifiers of good practice on issues such as treating customers fairly and how they deal with mortgage arrears. I do not think there is necessarily an inconsistency with being a commercial organisation and operating best practice.

Q154 Mr Love: You talk about excellent practice or best practice in your written submission but you do not go into it in detail; where does that excellent practice lie in terms of - let us take Lloyds TSB as a specific example. Where are they making mistakes, or without personalising it to one specific bank where are the banks making the mistakes, in your research, in terms of not acting in the public interest?

Mr Taylor: It would certainly be in terms of passing on the benefits of base rate cuts, it can also be looking at the interests of savers and borrowers which I referred to earlier in this session.

Q155 Mr Love: Let me just stop you there because you also say in your written submission that you accept that they have a role to rebuild their balance sheet, to repay the taxpayer investment, to increase their contributions to the financial compensation scheme, all of which everyone accepts. If that is the case can they deal with savers and borrowers in the way that they have dealt with them in the past or does there have to be some recognition of the particular situation that they face in this difficult economic climate?

Mr Taylor: It is an enormously difficult conundrum and we were very clear to put all of that in the submission so that we do not to appear not to have taken that into consideration. Clearly the extent to which they rebuild their balance sheet is a matter that can be considered in terms of how they are able to also support, through their liquidity, issues of all borrowers, so there is a balance to be struck and what we are keen to ensure is that they operate that balance fairly and in the consumer interest, which is why we have argued in terms of UKFI that there should be somebody with specific responsibility for defending the consumer interest.

Q156 Mr Love: You also talk about accepting that there would be an adjustment in the cost and availability of credit. The Prime Minister earlier today confirmed that they are indeed monitoring the availability of credit because there is a whole debate that we are having in this Committee about that, but in terms of the cost of credit does the Consumers' Association and the CAB accept that in these difficult economic circumstances there will indeed have to be a recognition that there will be a cost element to the way in which the banks operate at the present time?

Mr Taylor: Both over the short term and the long term there is going to be a need for a new equilibrium on the price of credit, and the issue of course is what is the consequence on consumers, particularly in the short term, and if credit becomes suddenly hugely more expensive for consumers that can pose a particular problem. I think we have seen, particularly with credit cards, where risk-based pricing has resulted in some very substantial increase in interest rates, which I know BERR have tackled, where we believe there may be some issues around unfair contracts. I think this is an issue that has got to be handled sensibly, fairly and reasonably but over a period of time I suspect we will find a different credit market in place.

Q157 Mr Love: Can I just ask the CAB is it fair for us - and I put myself in this as well as perhaps the CAB - to say that banks should pass on all the benefits of reducing interest rates both to borrowers and, if they are going to do that, with savers as well? Is that in the circumstances a reasonable demand of them in the current economic climate?

Mr Tutton: I kind of agree that where you are coming from there is a recognition that credit costs for consumers are going to rise and, to a certain extent, we would argue that in the past perhaps credit costs in some respects have been too low, credit has been too available, people have over-borrowed and that has been one of the problems we have seen in the past. I guess balancing that is our concern, particularly with mortgages, that with those people who are particularly vulnerable we have seen a 33% increase in arrears enquiries on mortgages. We will probably see something like 50,000 to 60,000 people with serious mortgage arrears this year. These are people hanging on by their fingernails; they need all the help that they can get. So our answer is I agree with what you are saying in the bigger picture that the credit prices are going to change and consumers are going to bear it. The other side of that coin of course is where there are headline credit prices. For many of the people we see what they pay for their credit is not just the interest rate, it is all the other charges - default charges, if you get into trouble - around it as well. So we have to bring that into the picture too; if headline rates change perhaps now is also the time to clear the stables out of all the other default charges and all the other things that cause problems for consumers, that has to come into it as well. So on the one hand, yes, we can see that rates might go up for consumers in the longer term as Doug says; however, I think lenders have to balance that against the need to protect mortgage borrowers because it will cost lenders a lot more in the long run and in the medium term if people start losing their houses in even greater numbers. Thirdly, we have to look at the price of credit as a whole which includes all the various default charges, service charges, admin charges that are added on top as well, and make sure that they are fair and consistent.

Q158 Mr Love: My final question, I have said that there is a lot of very bad practice going on there, you are there to expose that and we, hopefully, will be able to help you to do that, but let me ask you a very simple question. Someone who is on an 80-90% loan-to-value ratio, when it is likely that house prices will continue to decline - by what amount we do not know but let us call it 15% plus - in the future is it not right for banks and lending organisations to be cautious in those circumstances and will there not necessarily, as part of that caution, be an increase in cost?

Mr Tutton: Yes, but subject to protecting the most vulnerable.

Q159 Mr Todd: We have seen probably the most dramatic change in competition in this sector over the last 12 months that there has been in my lifetime, and that is taking the core banking services of current accounts, mortgages, loans and savings with the departure of a number of players altogether, so we have the Irish and Icelandic fringe banks disappearing from the market altogether, the merger that has been facilitated by the Government, the arrival of the state as an owner of a large chunk of the banking sector as well and the changes in the business models of companies like Northern Rock which has virtually withdrawn from some activities altogether. In your evidence you highlighted some of those areas of concern but not all of them; the banking sector has never been a particularly attractive sector in competitive terms anyway so this is going to make it a great deal worse, is it not?

Mr Taylor: The potential for that is absolutely clear. The Cruickshank review in 2000 found that the current account market was not competitive, the OFT Review in 2007 found that the market was not working well and there is further work being done currently by the OFT, so certainly in terms of the current account market there are serious issues. We now have a super-bank and a reduction in the availability as you say. In mortgages there is a genuine problem: the OFT again highlighted some of the competition issues in terms of mortgages as far as the HBOS/Lloyds merger was concerned; we found that 60% of people change their mortgages in research we have done and as the market contracts and availability disappears that is going to be more difficult. All the signs are that there could well be difficulties in what is not a particularly competitive market; although it would be fair to say that the mortgage market recently has been relatively competitive, when looking at the deals that are available now compared with 12 months ago availability is much less. I think it is an issue and we raised during the HBOS/Lloyds consideration that the OFT needs to keep under consideration the issue of that particular merger and we would hope that was the case.

Q160 Mr Todd: You also say that the barriers to entry into this market are likely to be rising dramatically and that without the arrival of new players like the Icelandics - whom we now look back at with horror, but nevertheless provided some novel products in the marketplace which some have regretted taking up, the Irish banks and so on - this is going to become a very moribund marketplace with really routine offerings with very little competitive edge in it. I could broaden this to the business sector where I imagine that that anxiety is shared as well.

Mr Cave: It is shared, more so because the survey we did of our members in late 2007 revealed that 45% of them who try to switch banks find it exceptionally difficult to do that. You cannot have competition unless you have the ability for people to move from one bank account to the next.

Q161 Mr Todd: These are good customers.

Mr Cave: Good customers, yes. We have seen recently a reduction by half I think in the amount of time a bank is required to process the information and details for switching, but I think more attention needs to be given to that.

Q162 Mr Todd: Would it be worthwhile having a further study in this area to perhaps sharpen our knowledge of some of this, because this is all anecdotal stuff which we can share but it is not obvious what the data is on the actual competition that is taking place because, as we have said, the human evidence suggests that it is very hard to make choices and exercise them?

Mr Taylor: The OFT work on personal accounts in the retail market is a good starting point and indeed there is continuing work around transparency within that area, but I am sure that would be very welcome.

Q163 Mr Todd: The decision that was taken to facilitate the merger, that raised anxieties but I think you accept that as a one-off perhaps it was the only way forward.

Mr Taylor: It was a pragmatic issue. We could not judge the impact on financial stability if that was not waved through so to speak; we were just keen that the secretary of state ensured that this was kept under future consideration and we would like to have seen some specific powers for the OFT in that area, but we will certainly be looking to the OFT to keep an eye on it.

Chairman: Can I thank you very much for your evidence, it is very helpful to us. We are at the early stage of the inquiry and we will build on comments that you have made. If you can pass that on to us, Mr Cave, that would be really helpful. Thank you very much.

Witnesses: Mr Michael Coogan, Director General, Council of Mortgage Lenders, Mr Stephen Sklaroff, Director General, Finance and Leasing Association, and Ms Angela Knight, Chief Executive, British Bankers' Association, gave evidence.

Q164 Chairman: Welcome to the second part of our session today. Could I ask you to introduce yourselves for the shorthand writer, starting with Michael?

Mr Coogan: Michael Coogan, Director General of the Council of Mortgage Lenders.

Ms Knight: Angela Knight, Chief Executive of the British Bankers' Association.

Mr Sklaroff: Stephen Sklaroff, Director General of the Finance and Leasing Association.

Q165 Chairman: Thank you very much. Angela, no surprise, the first question to you: we have had anecdotal evidence from the Federation of Small Businesses and others about the problems that small businesses are having with loans and whatever else and the general lack of availability of loans. It was mentioned about overdraft facilities being withdrawn, arrangement fees going up, changing covenants and the costs associated with that. Why is there a perception that there is not the lending out there and why is there the view that the banks could do more to help businesses and consumers?

Ms Knight: We all have to recognise first of all, Chairman, that it is a very difficult economic environment. As you know when you are running a small business a number of things happen to you more so than larger companies; for example, you suddenly find that you are getting paid slower whilst on the other hand you have to pay for your raw materials quicker and often in cash. Those of us who have ever run a small business - and I ran a small heavy engineering company in the late Seventies through to the late Eighties in the north of England, and part of that was through a very nasty recession - know that it is very uncomfortable indeed, so I have to say that I am not surprised that small businesses are concerned. As far as availability of finance from the major banks is concerned, as you all know from the statistics that we produce as the BBA, but indeed statistics that are borne out by others, lending to small and medium-sized enterprises not only has been maintained but has increased. However, what has been very noticeable is that a number of other lenders have left the market. Icelandic Bank is one of the obvious ones, another two groups are firstly non-UK banks who have previously lent into the UK - not surprisingly, they have got the same problems in their own country so they have taken their lending back there - and, secondly, there has been quite a lot of lending from the non-banking industry which again has gone away.

Q166 Chairman: You are talking about hedge funds, private equity, money market operations.

Ms Knight: Pension funds, some of the finance arms of major corporates, all who have provided lending, either directly or indirectly. That has gone as well and so what in effect the business community has been experiencing - many of them may not have a direct relationship but they will have some form of indirect relationship - is a gap in their financing at a time when they are having to pay quicker and they are being paid slower. Under those circumstances the best thing to do is get back to your major bank quickly, sort out your business plan for a nasty turndown and then get the arrangements in place. Some of that has not taken place; I do not think we have necessarily been quick enough off the mark and there have been a lot of changes made by the banks to get to their customers quicker.

Q167 Chairman: Just to get an idea of that, how much do you think the cake has shrunk in terms of lending available, given that some participants have now departed the market? Are you talking about 40% shrinkage?

Ms Knight: There are two ways of looking at it; I can give you both of them and presumably the truth will be somewhere in between. If you look at the Bank of England's financial stability report which they published at the end of last year you will see two things in that report: firstly that the savings ratio fell off a cliff in 2005 but, secondly, that of course the demand for finance carried on. The gap is £330 billion or thereabouts; the wholesale market was filling that gap, non-banking lenders and non-UK lenders were filling that gap, the securitisation was filling that gap. These things are not there. Do I think that the gap is as big as that? No, because of course we are now in a very significant downturn so I am sure that that has shrunk. If you look at the Financial Times today you get another bite of the cherry. The Financial Times today has published a pie chart, with which we would broadly agree, which shows what the major banks are lending to industry. Their gap there is 11% so clearly on the one hand there is a chunk of money that is no longer available, on the other hand there are also lenders who are not there. In a recession, after the initial start, the demand for working capital tends to diminish and we will be seeing businesses which are not sustainable through this current downturn. Where the gap actually lies is something the economists do really need to work out. What we do believe is that the announcements that were made today by BERR are going to be very useful and I think that that is something which will help both the small business but also a larger chunk of corporate Britain as well.

Q168 Chairman: The LIBOR rate, I think, has reduced by 3.5% since October.

Ms Knight: Yes.

Q169 Chairman: Why have these savings not been passed on to borrowers in full?

Ms Knight: Broadly speaking, the LIBOR drops have been passed on. I use the expression "broadly". There is another side to this, and that is called the saver. If you are a bank, you have both borrowers and you have savers and, actually, the more that you can bring in, in the way of deposits, the more, of course, you can lend out. In a situation in which you have got very low interest rates and in which you are passing those interest rates on - and I think there has been a very dramatic fall in interest rates over this last year: it is, what, 4% in 12 months - then, clearly, what you have got is something that is changing very rapidly as far as an organisation is concerned, but you still do need to attract savers. It is a balance, and there are many more savers than there are borrowers. At the moment those who are actually raising many concerns, and who can be surprised, are the savers, often prudent people who are now facing a much lower return on their money because of the low interest rates. You cannot please everybody all of the time.

Q170 Chairman: The committee has received a lot of representations and submissions for this inquiry and we have had evidence presented to us that banks have been passing on low rates to savers but not to lenders. In other words, we have had low savings rates but often high borrowing rates. Are the banks just pocketing a few bob for themselves here?

Ms Knight: No, is the answer to your question. I understand the point that you are making, but I do come back to you again, Chairman, and say that, broadly, you do find that the rate has been passed on. If you have got a fixed interest mortgage, for example, then you will not necessarily receive anything like the same benefit as if you have got a mortgage which is a tracker. So there are differences, and people made different choices at the start, but at moment as well one of the very noticeable things that is happening in the housing market and elsewhere is a reduction in value. That, of course, is affecting the assets that banks hold, it is affecting the risk weighting of those assets; the risk, therefore, starts to go up, so the amount of capital that banks have to hold against that risk also increases; and in an environment in which we have had to increase the total tier one capital that we hold, you have, in effect, got a double whammy.

Q171 Chairman: I understand. I do not want to get into this area, but in terms of your relationship with the FSA and their understanding of what "minimal capital" means and investor's understanding of what that means, are you happy with that arrangement?

Ms Knight: I think we have got quite a muddle out their, frankly. I have brought the committee a little equation which I will leave with you.

Q172 Chairman: Quadratic?

Ms Knight: I am delighted to say, no. I said to my capital people, Chairman, "Can we make this as simple as possible?", and when they did I then cut the rest out; so it is understandable, I can assure you of that. Let me try, as simply as possible. We went from, over night, a situation where as a banking industry we held 8% total capital as a regulatory requirement, of which 2% was core tier one, which is the expensive one, if you like, to a situation where we had to hold 8% tier one capital, of which 6% was core - a big jump. The FSA and, indeed, the tripartite authorities made a very valid point. They said, by increasing that capital, that provides more capital to absorb losses as we go into a recession and also to help sustain lending - a very valid point - and, indeed, similar actions were taken in other countries. However, as far as the market is concerned, of which, perhaps, I would particularly put two categories there: one is the analysts and the other is the rating agencies. In their view, 8% has become the new minimum. If we have rating agencies saying, "That is what you have got to do or, if you do not, we may review your rate", then we have got a significantly greater problem.

Q173 Chairman: I think we have got a long way to get to that.

Ms Knight: Absolutely. It is that educative feel, for which we actually see the authorities have a role: whether they are this country or in other countries, whether they are central banks or regulators, that is where the debate has to take place; otherwise we cannot use the capital for the purposes for which it was intended.

Q174 Mr Fallon: Angela Knight, coming back to the lending gap, if it is between 330 billion or 11% of total lending, presumably a scheme then of 10 or 20 billion that was announced today, however welcome, does not go anywhere near covering it?

Ms Knight: The demand has dropped as well. One of the things that is quite noticeable is the demand for credit has dropped. You can see that in all sorts of ways. For example, the demand for people to borrow for mortgages is one; that is not there at the moment. The high street is reporting figures which show that people are not purchasing, and certainly our own figures show that they are paying back loans. So the demand for credit is going down as well, and that is why I say to you I am not sure where the gap is. What I do know is that this is, at the very least, a good start.

Q175 Mr Fallon: The gap must be much, much wider than 20 billion, must it not?

Ms Knight: The gap is certainly going to be wider than that, but, equally, at the same time, you have got businesses that are taking other actions to their business model for the purposes of addressing the recession. Self-evidently, you do not expect to be able to sell the same number of goods or services in a recession that you did when you were on the rise and, if you look back to see what has happened in other recessions which you have had, you do find that, once one has gone through that first period, there tends to be quite a significant reduction in, for example, the demand for working capital.

Q176 Mr Fallon: I understand that.

Ms Knight: One other aspect is this whole business of credit insurance. I think we have got to come back to that.

Q177 Mr Fallon: I want to be clear about the lending gap. How can we judge here in Parliament whether the right figure is ten billion, 20 billion or 50 billion when you are not clear what the lending gap is?

Ms Knight: I think that we will certainly be able to assist in that a little further, but, equally, some of it depends upon what the Bank of England decides to do as it is addressing its money market at the moment. There are more ways to get to the end than one, and, indeed, we do ourselves believe that there are a number of issues that collectively need to be addressed of which this is one part.

Q178 Mr Fallon: Mr Coogan, you put out a statement last night, before you appeared here today, saying the Government should review the cumulative effect of its recapitalisation process on the willingness and capacity of large lenders to provide mortgage funding. You said, "The way in which Bradford and Bingley and the others have been bailed out has affected the capacity of other deposit takers, particularly building societies, to provide new lenders." That suggests that the bail-out is actually hurting the retail mortgage market rather than helping it.

Mr Coogan: I think the bail-out was necessary. Because we have had the bail-out, we have a more stable environment in which to move forward. We have had the further announcement on small business today, but there clearly is a case, and it has been made by a number of banks, that the cost of the bail-out needs to be reviewed. There are, according to press speculation, further announcements in terms of further interventions, and we would see, as part of that process, there is scope to look again at the terms that were placed last October on individual banks.

Q179 Mr Fallon: But how do the terms affect other deposit takers?

Mr Coogan: If we move on to the second question, which is the compensation scheme, the effect of asking deposit takers to bail-out Bradford and Bingley and the Icelandic banks has already had a significant effect in terms of the interest payments that would be expected to be made by the deposit takers and then the capital, if there are losses on the books in Bradford and Bingley. So what you are looking at is a draw on last year's profits, which has undermined the outturn which will be announced by a number of deposit takers, building societies, this year, and an ongoing financial underpin regulatory cost that was not there before, which is going to impact on their ability to lend.

Q180 Mr Fallon: If the other building societies should not have been expected to chip in, who else should?

Mr Coogan: The effect of going down the route which the compensation scheme would expect to do is bail-out from other people in the same business, but a consequence of it is to knock-on on the amounts of money available from some lenders for net lending.

Q181 Mr Fallon: And you want that reviewed?

Mr Coogan: I think it is important if we think activity in the market is not simply relevant to the borrowers but is relevant to the builders, the estate agent, intermediaries, the economy as a whole.

Q182 Mr Fallon: So the taxpayer should take a bigger share. Is that what you are saying?

Mr Coogan: I am afraid, you either reduce the price, the interest that the deposit takers are taking, or your look at the taxpayer, looking at that issue as a whole, rather than individual groups of institutions, but it is a difficult issue however you cut it. The question underpinning all of this is should we be trying to underpin the existing borrowers or should we be encouraging no activity?

Mr Sklaroff: Chairman, could I briefly intervene on the general question of lending business? Angela adverted earlier to the issue of non-bank lenders, and there is a particular point which I want just to make to the committee about this. While we too welcome the announcements that were made by the Government this morning, nonetheless, a major part of lending, defined widely to business in this country, is carried out by asset finance companies, a very large number of whom, a majority in terms of our membership, are not banks and, therefore, do not have access to any of the facilities which have so far been brought into existence by the Government and by the Bank; and one of the conversations which we are having intensively with the Government at the moment is to see whether we cannot get access to those schemes, such as the Special Liquidity Scheme, such as the Credit Guarantee Scheme, in order that this hugely important sector for investment in businesses of all sizes, but particularly SMEs, can be supported.

Q183 Chairman: If you got access to it, would it have a to be a bigger cake?

Mr Sklaroff: We believe there is unmet demand out there, and a good example actually is in the motor market, which has been the subject of much debate in recent weeks. We think we could, almost immediately, begin lending to more people in that market if we were able to obtain funds in the market at a better rate than we currently can.

Q184 Chairman: So you are going down the road of having a bigger cake?

Mr Sklaroff: Yes.

Q185 Sir Peter Viggers: In each of your cases, your clients would prefer to make large loans with good security and repayment without hassle?

Ms Knight: Yes.

Q186 Sir Peter Viggers: On that basis, you could, in commercial terms, afford to demand fairly low interest rates, modest interest rates, whereas a small loan of no security and difficulty with recovery means, in commercial terms, a higher interest rate. How do you square this circle? Who should bear that extra cost? The Government is urging you to lend. Are you prepared to bear the extra cost of the less commercial loans yourselves, are you prepared to accept coercion from government or do you think government should pay?

Ms Knight: I think, actually, if one unpicks both your question and the announcement today, we come to what looks like, I think I would probably call it, a sharing out, which may, I hope, be helpful. On the first point you are absolutely correct that, if your loan is secured and you have got a good business there, then it will impact beneficially the rate that you charge. If the security has dropped in value and the same amount of money is required by the business, then you are into a rather more risky scenario, and that risk then reflects back into the capital, and I will not go through the process, but you inevitably will have to charge more because it is costing you more to lend. There is a few things that can help. One is that you do not need any further intervention, the business and the bank look at the business plan and bring things into balance, and there is a lot of effort now being put in that area, there is a lot of special people that banks have put in, regional offices, and so forth, and seminars and other programmes taking place around the country. But the other part of it is possibly one of the things that is going to be important that comes out of the small business part of today's announcement: because that, in effect, says that in a situation where, for example, that business still wants to borrow X but their security is now worth less than X, then that additional amount of money that they require can be covered by the small loans guarantee scheme. I have forgotten; it is not called that. What is it called? Can anybody remember. Whatever its new name is.

Q187 John Thurso: Enterprise Finance Guarantee.

Ms Knight: Thank you. That is one way which is of significant help. It is 1.5%, I think it is going to be, the charge, so, again, it is in a sensible area. The larger part of the announcement of today's package, which will be perhaps more appropriate for the medium-sized enterprises, is one which the banks themselves pay for, and that is about parcelling up the loans, looking to see what sort of guarantee there is available for government, so releasing more money for lending. None of this is, clearly, going to say to every business in the country that the fact that there is a recession will make no difference to you, it does make a difference, but I do think there is a shared cost element here which will ensure that continuing provision of finance and some more finance at sensible rates for the borrowers.

Mr Coogan: I think in the mortgage market there has been a shrinkage in capacity, and there has been the Northern Rock effect last year where they have been looking to shrink their own business, and that has led to re-mortgaging at a substantial scale in 2008, and those remortgages have been at lower loan-to-values. There has been competition to get those customers at lower loan-to-values and the 40 billion net lending has typically been at lower LTVs than you would see in a normal market pre the credit crunch. So customers in that healthy position of high equity in their position and a credit history demonstrating their ability to pay, there is still competition for those customers; for those customers who need a deposit as a first-time buyer, there are very few products available where you do not need a very significant deposit compared to the past; so that pricing for risk is now low.

Q188 Sir Peter Viggers: Stephen, do you have any comment?

Mr Sklaroff: I do not think I have got any particular further comments on that. Our concern across all the markets that we represent is that we do have something like a level playing field in terms of access to funds in the market, and at the moment we do not, for the reasons I was talking about earlier. So that in the consumer lending market, including the second charge mortgage market which we represent, we have a similar split of companies between people who are banks and people who are not banks, and the point we are making at the moment is that, if you want an effect in the economy in terms of improving lending, you have got to address those firms which do not at the moment have access to the schemes that the Government has brought forward.

Mr Coogan: That applies in the mortgage market as well, especially if lenders are excluded - smaller lenders who do not qualify for the bank schemes.

Q189 Sir Peter Viggers: There are two criticisms that can be made of government intervention and the interface between government and the private sector. One is there is a lot of form-filling and bureaucracy, and the second thing is that when government does intervene it tends to distort the market and distort commercial pressures. Do you have experience of either of those?

Ms Knight: I think both concerns are correct ones to make. As far the first one, can we simplify both the form-filling process and the speed in which some of these issues are looked at, certainly from the banking perspective, there is still some work to be done, but that is where we are going. We hope to be able to turn round these inquiries, because the inquiries for the guarantees will come via ourselves, so we hope to be able to turn those round quite quickly. I will be able to answer the question as to how possible that is and how convoluted the form-filling is in a little while - today is only the first day of the announcement - but your point is a valid one; let us hope we can get through there. As far as distortion of the market is concerned, I think the answer to that question is that we need to take great care that we do not have permanent distortion of the market. I do not think anybody sees these interventions as designed to keep, for example, sticking with the business for a moment, businesses that are not viable afloat, because if you are keeping artificially afloat a non-viable business, all you are doing is weakening the strong and you are not really going to provide any long-term benefit. So there is that balance, and it is something that is going to have to be very carefully watched. In terms of the broader questions of distortion, is general intervention and the various actions that government has taken so far for the purposes of stabilising the financial system distorting? As you have heard from my two colleagues here, they feel that there is not necessarily equal access and, indeed, I am sure that that is something that is going to be hotly debated. The financial system stability is dependent upon the financial system working, and if the financial system works the banking system works, and we do not just have a problem here, we have a problem right around most countries which have financial centres of any substance in the world. So there is no perfect solution, actually, but I think there is a situation in which actions get taken and then one starts to look at making those actions better, more fair, more equitable as time progresses. One of the noticeable things in the mortgage world has been, as has been said, coalescence down on to the major banks and perhaps only two or three building societies, not just for the provision of new mortgages, but actually there is a huge amount of remortgaging going on as people with mortgages, both some in the building society sector, Northern Rock, for example, and specialist lenders, as they come up for renewal at the end of whatever their term was, they are seeing rates which they consider to be far too high and they are coming back to the major providers. That is something that is, I suppose, inevitable in a difficult time, but certainly over a period of time one wants to have a broader market and that ensures good competition.

Q190 Ms Keeble: I want to ask a bit about credit cards and store cards. Angela Knight, we have obviously seen the reports in the paper of Amex charging up to 46% on one of its cards. What is the general pattern of interest rates on credit cards and what is your perception about what is happening to those?

Ms Knight: The credit card situation is one in which the actual way a credit card looks at the sorts of rates that it charges is dependent upon that portfolio. Like you, I saw the list in the paper. I have been told that it was a bit of an apples and pears comparison because some cards have fixed charges and other cards do not, but, as with other areas, in credit cards there is a lot of choice for individuals and, indeed, there have been some statements made by the credit card industry, which in this instance was led by Apax, for the purposes of presenting a set of principles which the industry is all signed up to, not only of transparency, but also that gets into the whole area of rates, notice that is given if rates are going to increase and the frequency with which rates can increase. So I think there is a sensible pattern there and those principles are very much available. As far as store cards are concerned, store cards is not something which comes within my province.

Q191 Ms Keeble: I accept that. Do you think there is sufficient transparency, given the tendency to change rates, and do you think there is enough information provided about the fixed fees, the annual fees, in relation to the actual cost of credit, particularly now, when interest rates are going down and people should be able to get cheaper rates?

Ms Knight: This is something that this committee and, indeed, your Chairman has been quite keen on over a number of years, trying to make sure that there are simple boxes in which people can look and understand what their credit card is costing, what happens if they pay off at a minimum rate and what happens if they pay off at bigger rates, and it is not the easiest area that warrants simple explanation, unfortunately. I do not believe that we have necessarily got it all right, but I do not also believe that it is all wrong either. Clarity of explanation is essential, the summary boxes are essential, but also some of the commitments that have recently been agreed, not only about making the information as readily available and understandable as possible, but also commitments about rate changes. I think that that is important as well. We are not entirely sure, by the way, what is going to happen in the generality with credit cards. Use of credit cards is there. It is not increasing at anything other than a standard rate; it has not shot up. As to whether actual credit card use is now going to flatten out and diminish, we are not entirely sure. Again, I suspect that is going to be as much related to what is happening in the high street as possible; but that set of principles, we believe, is actually a very important step because it is certainly something that the banks are very much committed to but is also something by which the industry can be judged externally as well.

Q192 Ms Keeble: I wanted to ask Stephen about store cards. They have perhaps had less attention than credit cards. How significant do you think they are in the market? Can you put some numbers on it as well, please?

Mr Sklaroff: Yes, the numbers are down on store cards. The size of the store card market has actually dropped by about half over the last five years.

Q193 Ms Keeble: From what to what?

Mr Sklaroff: I am just checking to see if I have the numbers. If I do not, I will write to you. The latest per cent, yes, I have here. The total market in the most recent figures we have, which is the year to the end of November last year, is 2.8 and a bit billion, and that is down 1% on the previous year. To pick up a point that Angela was making, in the FLA we represent both credit card and store card companies. The two commitments that the industry made very recently at the Credit Card Summit which the Government held, which Angela was talking about, are very, very important, particularly in terms of this issue of risk repricing, where the interest rate is changed. What we have all now committed to is that when someone has taken out a card - whether it is a credit card or a store card it applies equally - within the first year of having taken out that card there will be no increase in the interest rate and, after that, not more frequently than every six months. Furthermore, customers will be given, not only plenty of advanced warning if there is going to be a change, but also the opportunity to terminate the arrangement if they would like to make alternative arrangements and pay it off.

Q194 Ms Keeble: Credit cards are one thing, but store cards are sold very easily over the shop counter. I was going to ask you about training and monitoring, and so on. If people find other sources of credit dry up, this is obviously, sometimes, an extremely easy source of credit, and we heard from the previous witnesses its interest rates are often round about 20-24% or so. What is your perception of the impact on people's personal indebtedness of the ability to get store cards, is their position going to change and how about the training?

Mr Sklaroff: To start with the training point, our industry, the finance industry, which sits behind the store cards, is very keen to work with, for example, the high street stores to ensure that training for shop staff who are selling store cards is as good as it could possibly be, and there is always more progress to be made in that area. We work very closely with them---

Q195 Ms Keeble: Saying that it is as good as it can possibly be is a sweeping term.

Mr Sklaroff: I am saying we would like to make it as good as it can possibly be. I would not for a moment suggest it already is.

Q196 Ms Keeble: What is happening about checking somebody when they sell you something over the counter, when they say, "Do you want a store card"?

Mr Sklaroff: What it means is that the customer should have a good understanding of what it is they are being offered. Earlier on this afternoon we heard that sometimes customers may not understand exactly what it is they are being offered, but if I can just go on to the other part of your question, it is important to understand that the borrowing limits on store cards are very, very much lower than they are for credit cards, quite deliberately, and the average outstanding balance on a store card now

- it has been dropping - is about £130, and it is a different sort of product from a credit card. I completely understand your question, because it is the other side of the same thing. A store card is designed, apart from anything else, to be used by a wider range of customers in the store than would perhaps be going to get a credit card. Therefore, the criteria are different and the interest rate is different, you are absolutely correct, but also the credit limit is very much lower. Very often these cards are not used very frequently during an average year - perhaps only four or five times - and the providers are very keen to ensure that customers are not becoming over indebted and, therefore, these rather low credit limits are put in place.

Q197 John Thurso: Angela Knight, can I follow up on the answer that you gave to one of the Chairman's opening questions regarding funding for SMEs in particular?

Ms Knight: Yes.

Q198 John Thurso: We had evidence in the earlier session from the FSB regarding their December survey, showing the difficulties they are having. This joins a pretty growing body of evidence which suggests that sound companies, and certainly all the ones that I have dealt with in my own constituency, follow this pattern - they are sound companies, they have a long banking relationship with their particular bank (one of the five or six main banks) - they are finding it difficult to get, in some cases, facilities renewed, in nearly all cases they are looking at quite large jumps in the margin - two to four, four to six, things like that - and they are also paying double the fees. Does that picture correspond to what the banking industry thinks is going on?

Ms Knight: I think the banking industry would say to you that that is the case in some instances, but it is by no means the case in all instances. Let me try and perhaps put a little bit of meat on those bones. What can quite often happen is that a business has come to the point at which it renews its facilities. It asks its bank to do so. From the perspective of the business it is the same people, it is the same business, they are asking for the same facility and they are producing the same product; so their assumption is that there is no reason why their facilities should not just roll-over. From the perspective of the bank, the economy is turned down significantly, the value on which those facilities has been secured has reduced, the situation as far as money is concerned is much less liberal than it was two, three, four years ago and, as far as that business's customers are concerned, they do need to look to see how good those customers are as well. So, if you like, the same situation, but there are two perspectives, and that is one of the reasons why the business community and the banks do need to get closer together, it is one of the reasons why a number of our members are now setting up seminars, 100, 150 around the country, it is why they have brought specialists in and they are doing better training as well within the banks: because, as you can see, there are two perspectives. Both in a certain way are correct, but actually it is the broader economic environment which is going to impact the price as well as the fact that we have gone from an area in which there was a lot of credit, very liberal and very finely priced, to a tougher scenario generally.

Q199 John Thurso: I take that point. I think there is a third person you need to put into that discussion, which is the Government, which I do not think has yet worked out that you cannot ask for free availability of credit at 2007 levels and an improvement in your balance sheet and get both at the same amount of money, as it were. One specific case I raised was regarding HBOS, where there was a significant increase. The asset collateral was over 250%, even on a reduced margin. There were three times interest cover, so these are not high numbers, but you are seeing quite it a bit, and it coincided with HBOS having put out a press statement saying they would maintain facilities for their customers. I wrote to Lord Stephenson to ask him to join these two things together, and he saw fit to give it to the customer care department, who, today, responded at a relatively low level to tell me it was just hard cheese and they needed to make more money. That corresponds precisely with what the director regionally in Inverness of HBOS and RBS have said are the instructions from their head offices, which may be precisely what they should be doing. I am not actually quibbling with that. What I am saying is that we need some honesty injected into all of this so that we can deal with it honestly. Would you agree with that?

Ms Knight: Yes, I do think there needs to be a considerable degree, or perhaps a greater degree, of honesty generally than there has been: because you cannot face in all directions at the same time, you cannot lend at the same price as when there was a lot of credit availability, you cannot have an increase in your capital requirements and at the same time be able to service everybody at a very fine rate and at a time of recession when, of course, the whole of the way that business looks is very different. So there is a need to have a true and honest discussion and a true and honest debate, and with the British people, because at the moment half the time they do not know what to believe, and, of course, you turn on the television in the morning and what you do is take fright. Recessions are not nice things. This is the third recession of my working life, unfortunately, and it is a very long time since the last one. One of the noticeable things as well (and I believe that this does infect this whole area) is this. If, for example, you came out of university in 1992 aged 22, 23, this is the first time that you have seen a recession. You are about 40. It has never been nasty for you and you are having to deal with something that is pretty tough. So I do think that there is something. A 40-year old is probably in charge of a lot of things, businesses and right across the piece, so I think there is something there that is not particularly helpful. As far as the banks are concerned, they do say and they have said, many of them, in recent statements that they are giving commitments to business lending and realistic commitments, proper business plans, but they do recognise that they need to get closer. I would hope that the sort of example that you cite is one that will fade in terms of its number, though with the millions of businesses there are around, millions of people in the industry, I cannot promise they will be perfect every time, but a much better relationship is required.

John Thurso: To what extent does the fact that there is still a lot of what has been called toxic debt sloshing around the system undermine confidence generally, particularly in inter-bank lending in the capital markets; and do you think there is merit in actually dealing with this by the bad bank scenario, where that is taken out of the system so you can put the confidence back in lending, so that banks deliver the solution rather than BERR?

Chairman: That begs a long answer. Keep it short.

Q200 John Thurso: Just, yes, will do.

Ms Knight: I will try on that. For toxic debt, I presume you mean exposure to structured products, very difficult to value if at all---

Q201 John Thurso: Exactly; difficulty of valuation.

Ms Knight: ---probably got some US subprime in them, but still paying some sort of income. Actually that has been very difficult for the industry around the world under the mark to market rules. There has been some changes. So, clearly, there is something there, though I think you also have to recognise that there is not necessarily a big toxic debt problem in the UK. What there is is a large amount of assets whose value has dropped, which are perfectly good assets, such as those relating to housing. Inevitably, if your risk and your assets are going up and if you have got assets which are hard to value, it absorbs capital and it constrains lending. There is nothing further to say on that point. On the second one, do you need some sort of toxic park here in the UK? That is something that has been heavily discussed within the press, as you know, and it has been heavily discussed with analysts. I am not entirely sure that the case is made for that all. I think what the case is made for is a broader liquidity scheme operated by the Bank of England. I think there are other broader scenarios elsewhere, I think some of this will depend upon what Europe decides to do as well and I think we have still got an example in the US which has not yet worked.

Q202 Chairman: Angela, just before you pass on, will there be further write downs with the banks? Just give us a simple answer, yes or no?

Ms Knight: I am sorry?

Q203 Chairman: Will there be further write downs with the banks. Will they come out with further write downs?

Ms Knight: Whatever the banks are holding on a commercial basis is for them, Chairman, it is not for me. I do not have insight into---

Q204 Chairman: As a representative of the BBA, you do not have a clue?

Ms Knight: No, I did not say that, Chairman, so, please, do not put words into my mouth. What I said is I am not privy to the private commercial issues of each and every bank. Nor should I be. We are in a reporting season, we need to wait for that, and the last thing that anybody needs is speculation. There is enough speculation from others.

Q205 Nick Ainger: Mr Coogan, we had a submission from Which? which indicated that they expect that if house prices fall by a further 15% in 2009 there could be 1.5 million mortgage holders that have got a loan-to-value ratio of over 90%. A significant number of those will be coming to an end of a fixed-term deal and will find it enormously difficult or enormously expensive to remortgage. What can be done to help those people?

Mr Coogan: The first thing we have talked about is trying to open up those funding liquidity schemes that are made available in the coming months to a wider range of firms that may be able to offer refinancing. I think the straightforward answer the Government has come up with is to try and encourage lenders to reduce their rates so that, when people go on to a standard variable rate, there is not the payment shock that would have been the case 18 months ago. That strategy has worked because people coming out of fixed rates now are more likely to be able to address the SVR issue than they would have been.

Q206 Nick Ainger: There are those, though, who are not coming to the end of their deal but are being informed by their mortgage lender that, as their ratio has gone over 90%, which was the deal that they struck when they took out the mortgage, they are now being asked to actually make an additional contribution to actually bring their loan-to-value ratio down to at or below 90%. Is that common throughout the industry?

Mr Coogan: I have seen speculation to suggest that least one lender has written to its customers in that situation, but I believe the situation is that they are warning customers about the lack of available drawdown facilities. I am not aware of any lender which has asked for money back, and clearly that would be an issue which the consumer press would look at very quickly so that the regulators would look at whether there is a fair term being applied fairly by the individual lender for those customers.

Q207 Nick Ainger: I have got here a letter from Abbey, and I will quote from it: "If when we receive the updated value of your property the amount that you have already borrowed means that your mortgage balance exceeds 90% of the new value, then we will give you three months to bring the balance back down to 90%." Do you approve of that sort of policy?

Mr Coogan: Individual commercial decisions will have to be taken on their individual terms. Clearly, for customers in a situation where they have got stretched finances, the lender will have to look at what is realistic for those customers. I think what customers will need to do is respond to letters they receive to find out if they are being treated fairly under their terms.

Q208 Nick Ainger: This was a mortgage taken out in 2007, not long ago. These people have never ever missed a payment, and yet they are being threatened that if they do not pay a significant sum then action could be taken; they will be in breach of the terms of their mortgage. Abbey, following pressure, have said that they have no intention of invoking that clause in the mortgage agreement, which is welcome, but the threat still hangs over them and, presumably, other people. Do you not think that you as an organisation should be asking your members not to actually carry out that sort of policy?

Mr Coogan: I think in this environment it is difficult to see customers being able to make those sorts of payments. It is a commercial decision of the lender whether to write in those terms or at all to customers to draw their attention to the effect of house pricing rules. Yesterday at a CML event we had a speaker from the FSA reminding members of the Unfair Terms Contracts legislation and the importance, not only to have fair terms, but to apply them fairly. Whether that term is fair or not, I cannot comment, but the issue is a live one within the industry as a whole. The publicity surrounding that particular case is widely available to the rest of the industry.

Q209 Nick Ainger: So you do not think it is going to be a policy which is going to continue and it is not going to spread to others of your members?

Mr Coogan: For individual organisations, they are going to have to take commercial decisions. We have already seen in the area of trackers, where there were floors which have not been applied in one or two cases, that individual companies are addressing the current recessionary circumstances and trying to respond to their customers' needs.

Q210 Nick Ainger: But do you not think that members of your organisation also have to bear some of the risk when house prices are falling? It does not just fall back on the borrower, but the lender should also share some of that risk and, therefore, they should not be following that sort of policy?

Mr Coogan: They do share the risk, because if the loss ever has to be crystallised into repossession and sale, they are not getting their money back in the vast majority of repossessions, of which we reported an expectation of 45,000. So in the vast majority of those cases they did make losses when they crystallised the debt. So they are at risk, they know that is the case; that is why they are keeping people in their homes as far as they can; that is why they are being realistic about what customer affordability is.

Q211 Nick Ainger: Let us move on to those that are facing repossession then. Shelter has called for improvements in the law regarding mortgages, and particularly those that are in arrears. They are objecting to the fact that under the current legislation lenders can force a sale based on only two months in arrears. Do you think that should be changed?

Mr Coogan: I think the approach of the legislation in 2009 is being reviewed by the Government as part of a wider ranging response to the recession. They have already, with our support and the courts' support, introduced a protocol. We have already seen, through the lending panel and the industry as a whole, support for a moratorium of three months, a number of individual lenders have said six months before they pursue arrears through starting court proceedings. So the risk that Shelter highlights may be a legislative one is not a real one in practical terms. What the legislation should or should not do is one of the things the Government is currently reviewing, and we are active in that role. What I should say is, if you go too far to make customers' position in their homes too secure, unable to be repossessed, that impacts security that already exists, impacts the future pricing of mortgages.

Q212 Nick Ainger: What about the foreclosure where a lender can actually claim all the proceeds of a sale, whereas in fact there may well be a balance that should be returned to the home owner?

Mr Coogan: If there is a balance, it should be returned to the home owner.

Q213 Nick Ainger: One final point. Perhaps this is for Angela Knight. Some banks are imposing a charge for every letter or call regarding arrears. Is that not a disincentive for people, as you have said, urgently to come forward if they are facing problems? When we are looking at trying to help people stay in their homes, address their financial problems, actually substantial charges per letter is not a good way of encouraging people to come forward?

Ms Knight: I had a discussion with a number of our members, before coming to this Select Committee, on some of the broader issues, of which that is one, on how are you getting close to your customers at a time in which many of them may well find themselves in anything from a more difficult situation to very difficult financial problems, and all them have come back to me with the same sorts of statements that they are putting in place, or have already put in place, arrangements whereby they can monitor closely and they can get to the customer quickly to assist them, if they are looking at getting into more difficulties as to how they can prevent that and, in some instances, how to get them out. I am afraid I do not recognise the specific question you ask - I will take it away - it certainly was not something that was raised with me that charges of that sort of nature were going to be levied. It is all about getting people through a difficult time.

Q214 Nick Ainger: Should it not be in the Code of Conduct?

Mr Coogan: I was going briefly to say that we issued the industry best practice in addition to the court protocol, and you do not charge every contact, you are encouraging people to come in, and we have issued consumer information on what they should expect to receive and what they should expect to do to try and make sure that they have a dialogue early, that they are not over charged, that they are charged appropriately.

Chairman: I think these are messages to take away both to yourself and yourself, particularly the Abbey one. It is maybe a good case study for the rest of the industry as well, so if you can take it away and tell them that the Select Committee want to look at that, that would be good.

Q215 Mr Love: I want to look at some of these issues but in relation to those banks that are in receipt of significant public funding. Do they have any form of duty to the public interest? Should they be, more than everyone else in the market place, recognising and accommodating the consumer interest? Perhaps Ms Knight would like to start and I will then come to Mr Coogan and ask him as well.

Ms Knight: I think the answer to your question is that those banks for whom there is a significant taxpayers' involvement have all given some fairly clear commitments, concentrating on lending as far as the UK is concerned. I think one of the aspects of this is that it is surely about using the taxpayers' involvement money wisely. They have clearly a requirement to lend in an appropriate manner, sensible lending policies, and they have also undertaken, as I said, to make finance available to small businesses and, indeed, to individuals in particular; and those banks are, after all, collectively very strong, both in the SME market, making finance available, and they are very strong in the mortgage as well in order to assist both in remortgage by providing remortgages and new mortgages. I am sure that wanting them to use the taxpayer involvement, if you like, in a wise way is one of the most appropriate things that they can do.

Q216 Mr Love: I want to come back to you, but let me turn to the CML. You talked earlier on about Northern Rock and re-mortgaging taking place at a pretty regular rate. We were told earlier on that currently Northern Rock are incentivising staff to take lenders off their books. My understanding is that their standard variable rate, which you spoke about earlier on, is significantly higher than that of other mortgage lenders. Is that the type of practice that you would say is in the consumer interest?

Mr Coogan: I think there are a number of different consumers in this issue. There are the consumers in Northern Rock, encouraged to remortgage, who are, there are consumers in Northern Rock who do not have the capacity because of their loan-to-value and whether they are being treated fairly and then there is the effect in the market as a whole, the consumers who are not able to borrow from other institutions because there is not the funding available for house purchase. So there are different consumer interests at play. I think the reasons that a business take a decision was set out in their business plan, agreed with government and agreed with the European Commission, and if that plan can be revised in a way that would make more flexibility for all concerned, I think there would be benefits overall.

Ms Knight: They were required, as part of that agreement, to unwind their mortgage book.

Q217 Mr Love: I understand that. The Government also asked the industry to maintain the flow of credit to the market place. Whilst I recognise that they need to pay back the money that has been given out of public funds, is there a proper balance, in your view, between the challenges that they face?

Mr Coogan: I think the original plan predated the worst part of the credit crunch after Lemans and, I think, needs to be revisited accordingly. In terms of how much they could do whether on savings or mortgages, there was a general underlying concern that they should not be allowed to compete against other players in the market unfavourably because of their nationalised status. So, again, we need to look at this in the light of 2009 circumstances, and they are different to the early part of 2008.

Q218 Mr Love: We heard earlier on that whilst, on balance - and you can only take an average - most of the reduction in interest rates had been passed on to a reduction in savings rates, that is not the case in terms of those who hold mortgages, where, certainly with the last reduction, mortgage holders are still having to pay. Most of what they would have received as a reduction should have been passed on. We are also seeing arrangement fees, additional charges. There is a whole panoply of things that are occurring at the moment in all of these organisations which the CABs would characterise as not best practice, and this includes the organisations in receipt of public funds. Do you think that the industry is responding adequately to the concerns that are being expressed about the way things are moving currently?

Ms Knight: First of all, the banks have each in their separate ways made statements in this area both in terms of rates, both in terms of personal customers and for small businesses, but your point is actually a valid one, and that is how can one continue to pass on rate reductions, offer reasonable rates to savers and run a business and also ensure that you hold the amount of capital that are required by external authorities and the capital that are required by the market? That means, if you are going to do all those things, that there are times when you cannot pass on rate reductions, there will be times when you would like to offer better savings rates but your hands are tied and there are times when you have to use money for capital purposes when you would rather use it for lending, and that comes back to an earlier point that was made that it is actually much better to have an honest, open, more rounded discussion about these things, although they are complicated, and I quite accept that, rather than just targeting one particular area and pretending that we can do everything at the same time when we cannot.

Mr Coogan: Can I also add that the number of customers on a standard variable rate where there is a choice to be made is only around 10% overall and for some of the institutions much less than 10%.

Q219 Mr Love: It has been suggested to us in some of the submissions that those in receipt of public funds should be leading the way and reducing standard variable rates. Where I understand it is only 10% of the market place, that would be a clear signal that there was a recognition amongst the banking fraternity of the pain that is being suffered out there whilst not prejudicing their need to have a commercial return at this particular point.

Mr Coogan: There is tug of war, where the banks and building societies are the rope and the Government are pulling in every direction. Savers on fixed interests and returns are going to be keen to maintain that lifestyle, they are not going to be happy for the small number of SVR customers to be benefited, and you are still looking as a government to have net lending nearer 2007 levels than our forecast of a negative net lending figure in 2009.

Ms Knight: To add to that point, if you look at some of the money fact tables, best-buy tables for mortgages, for example, you find that the major banks, including ones that you comment upon - I do not mean the Northern Rock, but I mean the big banks who have got a government shareholding - are featuring very strongly; that is they are still there making that availability when others are not.

Q220 Mr Todd: The market for financial services in the UK remains highly competitive. I think you heard the last few exchanges of the last session, which did not get much assent to that view. Can you square that opinion?

Ms Knight: I think that what we have got, obviously, is a market that is coalescing at a very fast rate, and I do not just mean the banking industry, I mean the broad financial services market---

Q221 Mr Todd: And building societies as well.

Ms Knight: ---is now much narrower for practical purposes than it was a year ago. That does not mean that it is an uncompetitive market. It is a difficult market, but there is quite a lot of choice in the market, and I would sincerely, not only hope, but expect, that as the recession bottoms out and starts to turn up we will get a greater degree of competition than we have at the moment, but I do not think that you can expect, on the one hand, that one has one bank stabilising another bank whilst, on the other, have exactly the same competition as you had before that event took place. You cannot have building societies not being able to lend in the market and have the same sort of competition for mortgages that before that took place, but we nevertheless do, I am glad to say, remain having a significant amount of choice and, certainly speaking for the banking industry, you have different banks specialising in certain sectors, some in SMEs and, of course, some in mortgages and others in other directions.

Q222 Mr Todd: I think there is probably quite a lot of competition for someone like me, but there is a large number of people who really have very little choice. I think you heard the witness from the Federation of Small Businesses saying the kind of information they are getting of the difficulties of getting genuine choice in basic banking services for a small business, and even one that is relatively secure and should be a reasonable risk. We are talking about competition in a very refined market place of relatively well-to-do people with solid asset bases and reasonably reliable employment, although, I have to say, that does not actually apply to me.

Ms Knight: I am delighted to learn of the comfort of your position! As a general comment, there is always more choice for somebody who is in a more comfortable financial position than there is for people who are not in such a comfortable financial position.

Q223 Mr Todd: If you look at the fundamentals of the market place, you are seeing a lot of consolidation, you are seeing probably at least a medium-term presence of the state in the market place, which tends to be an impediment to competition as well, you see the withdrawal of a lot of the fringe players and barriers to entry in them coming back going up rapidly. This is going to be a market place which, in spite of what you have said, was never applauded for its competitive nature becoming even less competitive into the future. What are we going to do about it?

Ms Knight: There is nothing that we can do as an industry to suddenly magic more people into the market place. What certainly can happen is that there is greater attention paid to competition of products and diversity of products, and, indeed, if one goes back to some of the points that were made earlier about codes and principles and so forth, these are not just pie in the sky or fine words on pieces of paper, these are genuine attempts to ensure that there are goods and services available from the financial services industry to the very wide range of individuals and businesses in the UK. Not everybody will be perfect with their finances and not everybody will find that they see their way through the recession with their finances in good order, and that is the same for businesses, but using the various other tools of disposal of the authorities and, indeed, of the industry itself, we can certainly make sure that there is a broad brush provision given the constraints that we keep on coming back to of liquidity, of capital, of availability of credit.

Mr Sklaroff: Can I add the comment, perhaps one obvious point from what I was saying earlier, that one very good way of injecting some more competition back into the lending market is to allow the non bank lenders access to some of these schemes.

Mr Todd: Good point.

Q224 John Mann: A return to normal competition rules. Is that rules from 12 months ago?

Ms Knight: I presume you---

Q225 John Mann: It is in your submission.

Ms Knight: It depends what you are referring to. Do I think we are coming back to---

Q226 John Mann: You said you would expect to see a return to normal competition rules in time. Do you mean 12 months ago?

Ms Knight: Yes. There is---

Q227 John Mann: Twelve months ago. So if we look at competition then from 12 months ago, would it be better competition, if we take door step lenders, if rather than having one of them lending at 172% APR, we had, say, 20 lending at 50% APR? Would that be better competition?

Ms Knight: Firstly, as far as competition rules are concerned, we would not normally expect to have invoked the public interest clause in competition for the purposes of allowing one financial institution to stabilise the other and, thereby, take a larger than normal share of the market. That is one aspect of competition. In terms of other aspects of competition (and you are citing doorstep lenders and concerns there), as far as the banking industry from our perspective, as you know, we are strong supporters of, for example, credit unions and other of those types of---

Q228 John Mann: That is not the question.

Ms Knight: Then I am not understanding your question; I am sorry.

Q229 John Mann: Twelve months ago there were loads of people going round my constituency and elsewhere with APRs, doorstep lending of 26, 30, 40, 50%. Is that a good thing? That is competition.

Ms Knight: That is one of the issues that is regulated by the office of Fair Trading, not by ourselves.

Q230 John Mann: Could we not do with losing some of the market?

Ms Knight: I do not know what will happen in this downturn.

Q231 John Mann: Would it be a good thing if we lost some of the market?

Ms Knight: I, too, share some of your concerns about some of the high-price lending stories that I have read. I, too, would prefer that individuals got their finance at the more competitive rates for others. I also recognise that we should not put all doorstep lenders in the same pot. As to what has happened in your constituency, I cannot comment.

Q232 John Mann: The mantra of competition seems to have masked quite a lot of incompetence. A case that came in front of me this weekend of a series of 95% mortgage, three unsecured loans, one secured loan, totalling 150% debt-to-asset ratio and increasing daily. The taxpayer is going to have to pay for that, and that is incompetence, is it not? Would not my constituents be better off with a choice of 100 or 200 mortgages rather than 12,000, if that kind of financial incompetence by lenders was restricted and we had a healthier market where competition was defined by real choice rather more choice?

Mr Coogan: Coming in here, in terms of the mortgage market, obviously, with the experience of the United States in the backdrop, was it a good idea or a bad idea to have invented a subprime market in the UK? After this recession, when there are people who have lost their jobs and had poor credit histories, how do we rehabilitate them and bring them back into the mainstream at lower interest rates than the mainstream banks? The subprime market in the late 1990s helped to achieve rehabilitation for customers. That also lea to entrants into the market pricing subprime loans at below the price of risk, and that was part of the precursor to the events of 2007. So what we need is competition which is properly priced, a rational price for risk. One of the questions I was asked earlier: what we need is a broad range of product providers of various types, not just banks or building societies, or specialist lenders, preferably or, preferably large and small, not just large, and what we need are products that meet the needs for customers at different stages of their life.

Whether that is 200 or 2,000 or 12,000, what you need is to have access to a choice. Clearly, some your constituents are making borrowing decisions when they cannot enter the mainstream market. There are also responsibilities on consumers.

Q233 John Mann: Therefore, a return to 12 months is not necessarily what we would want to see in terms of the market that is there. We would be better off if we shrunk certain parts of the market to allow others to grow and, in particular, the subprime market?

Mr Coogan: I would say that the mortgage market is dysfunctional and our challenge is to reopen the market to more lenders to make it the competitive market that was at one point the envy of the world but is not at the moment.

Q234 Chairman: One last question. When David Tweedie was here, he mentioned an IMF figure of 1.4 trillion dollars, the estimate for bad loans, but only about $600 million to date has been accounted for. Would you agree with those figures as ball park figures from David Tweedie?

Ms Knight: They are both broad estimates, yes, and I have no reason to either say they are right or wrong, but, I would have thought, they come from an eminent body, so they could be right. I think that one of the areas that we all do not know about is how much of that is not in the banking system at all, because, of course, there is a significant proportion of assets that have been bought by countries, for example, where the requirements are not to disclose by entities who have got them in different parts of their book and so do not have to declare on a mark to market value, and the last thing is that with a lot of this assets, they are still providing an income stream. What there is not is a market to purchase them. That can come back. The big question is that they are very complicated, all be it that in many instances they were triple-A rated by the rating agencies. That market may come back, we do not know what the default rate will be, but they are still paying a sensible income stream.

Q235 Chairman: Stephen, do you agree with those ball park figures?

Mr Sklaroff: Again, I have no particular reason to disagree with them. As Angela says, they come from a very good source.

Chairman: Okay. Can I thank you for your evidence; it has been very helpful.