



BRIEFING PAPER

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Consumer Credit Regulation

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Summary

This note describes the changeover of the regulatory regime for consumer credit from the Office of Fair Trading to the Financial Conduct Authority which will take place from 1 April 2014. It looks at changes to the treatment of various groups under the changeover and includes references to further information.

1. Introduction

The consumer credit industry is substantial and diverse. Consumer credit businesses can include banks, payday loans companies, home credit companies, mail order companies, those providing credit for goods, credit cards, store cards, debt collectors, financial advisers, pawn brokers and credit brokers. According to the Financial Conduct Authority (FCA) which will be the regulator for the industry from 1 April 2014 the industry is worth about £200 billion and involves something like 50,000 firms.¹

¹ FCA press release 28 February 2014

2. Regulation

2.1 The 1974 Act

The previous regulatory regime was statute based, established by the *Consumer Credit Act 1974* as amended by the *Consumer Credit Act 2006*. The principal enforcer of the legislation was the Office of Fair Trading. For the purposes of the CCA 1974, 'individuals' includes natural persons, unincorporated associations and partnerships of any size where the credit provided or payments for hire do not exceed a specified limit (currently £25,000).² The CCA 1974 does not apply to credit or hire agreements made between traders and corporate bodies such as limited companies. The main objective of the CCA 1974 is "to provide for the small individual borrower the protection he unquestionably needs without setting up artificial barriers between one sort of credit and another."³

There are many types of agreement which can come within the terms of a 'regulated consumer credit agreement' (provided they do not exceed the financial limit of £25,000). These include:

- hire purchase
- conditional sale
- credit sale
- personal loan
- overdraft
- loan secured by way of a second charge (land mortgage)
- credit card
- pledges
- budget accounts in shops

The CCA 1974 contains detailed rules covering:

- the form and content of agreements;
- the advertising of credit;
- the method of calculating the Annual Percentage Rate [APR] of the total charge for credit;
- the procedures to be adopted in the event of default, termination, or early settlement;
- extortionate credit bargains;
- individuals' access to credit reference files;
- equal liability of creditors and suppliers for misrepresentation or breach of contract by the latter; and
- hire purchase transactions.

In effect, the CCA 1974 regulates all aspects of individual consumer credit or consumer hire agreements including: entry into agreements (Part 5), matters arising during the currency of the agreement (part 6); and default under and the termination of agreements generally (part 7).

² When first introduced, the CCA 1974 covered most credit agreements up to a financial limit of £5,000, this was increased to £15,000 in 1985, and increased again in 1998 to its present limit of £25,000 – each increase was to reflect inflation

³ *Consumer Credit*, Cmnd 4596, Report of the Committee, Lord Crowther, 1971, (s) 6.6.3 – 6.64

The CCA 1974 also regulates the giving of security in relation to the agreements it regulates and pawn-broking (part 8) and the licensing of ancillary credit business (part 10).

A key feature of the legislation is the requirement that firms have to be licensed by the OFT before they can offer credit. This gives the OFT a 'nuclear' weapon in its regulation of firms, in that it can put them out of business. However, a charge against the system was that too much emphasis was placed on scrutiny at the entry stage and not enough on the ongoing activities of licensed firms.

2.2 The developing market

Since the introduction of the CCA 1974, the UK credit market has been transformed. Before the financial deregulation of the 1980s building societies only provided mortgages, banks provided consumer loans and overdrafts and supermarkets sold fruit and vegetables. Now, the market for credit has become highly developed and diversified. The number of licensed lenders, the range and complexity of credit products and the sales strategies used by creditors has developed at an unprecedented rate. This blurring of the boundaries has undoubtedly increased competition but it may also have contributed to some of the less desirable aspects of market behaviour.

Not only have finance providers changed but their sales methods have too. Mailshots offering 'guaranteed' loans and credit approved after a few clicks on an internet site became more common. Credit card 'cheques' appeared in people's post offering thousands of pounds of unasked for credit. Lenders started to use mobile phones to encourage borrowing at moments of maximum temptation – late at night. The payday loan industry was virtually non-existent in the mid-1970s by 2000 operators were on every high st.

Given these developments it is not surprising that UK consumers avail themselves of the services of lenders much more now than in the past. A 2003 DTI paper estimated that the average level of outstanding debt per person, in real terms, has risen from £86 in 1969 to over £2,700 by 2003. In the 1970s, £32 million was owed on credit cards, by 2003 over £49 billion was owed.⁴ Debt, both in volume and the number of people with debt problems grew and the legislation did not appear able to keep pace. A stream of consultations and investigations followed.

In its White Paper *Modern Markets: Confident Consumers*, published on 22 July 1999, the Government stated its intention to bring consumer credit legislation up to date so that it provides appropriate consumer protection.⁵

A Taskforce on *Tackling Over-Indebtedness* was set up in October 2000.⁶ On 1 July 2001, the DTI published a consultation document,

⁴ Department of Trade and Industry White Paper, *Fair, Clear and Competitive – The Consumer Credit Market in the 21st Century*, Cm 6040, 8 December 2003

⁵ Department of Trade and Industry White Paper, *Modern Markets: Confident Consumers*, Cm 4410, 22 July 1999

⁶ The Taskforce on Tackling Over-indebtedness has reported twice to Ministers and many of their recommendations were incorporated in the DTI's White Paper, *Fair,*

Tackling loan sharks and more!, in which it sought views on the effectiveness of the existing regulation of information disclosure, early settlement, unfair credit transactions, consumer credit licensing, the financial limit above which agreements are not regulated under the CCA 1974 and consumer redress.⁷

A White Paper, *Fair Clear and Competitive - the consumer credit market in the 21st century*, was published in December 2003.⁸ In this paper, the Government concluded that the CCA 1974 was becoming out of date in the context of a diverse and complex consumer credit market:

The laws governing this market were set out a generation ago. In 1971, there was only one credit card available; now there are 1,300. 30 years ago, £32m was owed on credit cards; now it is over £49bn.

The regulatory structure that was put in place then is not the same as the regulatory structure required today. As the credit market has developed, reforms have become necessary to modernise the current regime and update it for the 21st century.⁹

The White Paper outlined plans to use both secondary and primary legislation to improve the regulation of consumer credit. On the same date, 8 December 2003, the DTI published a consultation document, *Establishing a Transparent Market*, which sought comments on those legislative changes that could be achieved through secondary legislation.¹⁰ Subsequently, the following Statutory Instruments were laid before Parliament:

- *Consumer Credit (Disclosure of Information) Regulations 2004* – to ensure that contract terms and conditions in credit agreements are fair and written in plain English.¹¹
- *Consumer Credit (Agreements) (Amendment) Regulations 2004* – to introduce one set of rules for paper and electronic communications concluding credit agreements.¹²
- *Consumer Credit (Early Settlement) Regulations 2004* – to introduce a more accurate formula for determining an early settlement figure than Rule 78 and details of early settlement rights to appear on the face of the credit agreement.¹³
- *Consumer Credit (Advertisements) Regulations 2004* – to ensure clearer and more understandable credit agreements.¹⁴
- *The Consumer Credit (Miscellaneous Amendments) Regulations 2004*.¹⁵

Clear and Competitive – The Consumer Credit Market in the 21st Century, Cm 6040, 8 December 2003

⁷ DTI consultation document, *Tackling loan sharks and more!*, 1 July 2001. A summary of responses was published by the DTI in February 2002 (see the Appendix to this Paper)

⁸ This White Paper can be viewed on the DTI website at: <http://www.dti.gov.uk/ccp/topics1/pdf1/creditwp.pdf>

⁹ Department of Trade and Industry White Paper, *Fair, Clear and Competitive – The Consumer Credit Market in the 21st Century*, Cm 6040, 8 December 2003

¹⁰ The consultation document can be viewed on the DTI website at: <http://www.dti.gov.uk/ccp/topics1/pdf1/creditpiu.pdf> Responses to the document can also be viewed at: <http://www.dti.gov.uk/ccp/topics1/pdf1/creditconres.pdf>

¹¹ SI 2004 No. 1481

¹² SI 2004 No. 1482

¹³ SI 2004 No. 1483

¹⁴ SI 2004 No. 1484

- The *Consumer Credit 1974 (Electronic Communications) Order 2004* – to enable the use of electronic communications for concluding regulated agreements and when sending notices and documents.¹⁶
- The *Consumer Credit (Enforcement, Default and Termination Notices) (Amendment) Regulations 2004* - to ensure that all such notices sent under the Regulations are sent in paper format.¹⁷

The remaining proposed reforms (relating to unfair credit relationships, consumer credit licensing, the financial limit and consumer redress), were identified as being necessary in the White Paper but required primary legislation and hence formed part of the, new *Consumer Credit Bill*.

2.3 The 2006 Reforms

The main aim of the new bill was to reform the CCA 1974 under four broad headings:

- To enhance consumer rights and redress - by replacing the current 'extortionate credit' test with a new test based on unfairness, and by introducing an Alternative Dispute Resolution (ADR) scheme.
- To strengthen the regulation of consumer credit businesses - by creating a more targeted credit licensing regime and equipping the OFT with new powers (by way of intermediate sanctions) to take action against rogue traders, including financial penalties.
- To extend regulation to all types of consumer credit and hire agreements (subject to limited exemptions) – by abolishing the financial limit that currently restricts protection under the CCA 1974 to loans of £25,000 or less.
- To provide debtors with new post-contractual information.

One area of concern was the licensing regime which underpinned the 1974 Act. The reforms introduced by the Bill brought it closer to the system of authorisation operated by the Financial Services Authority under the *Financial Services and Markets Act 2000*. It gave the OFT wider information gathering powers to determine whether a credit provider is fit to hold a licence and imposed a more vigorous 'fitness' test for assessing the suitability of applicants and the OFT will have powers to ensure the ongoing fitness of licence holders.

The 'fitness test' was broadened enabling the OFT to look at an applicant's past track record for misconduct and other offences, and also assess his competence and his preparedness for running a credit business.¹⁸ If an applicant satisfies the OFT that he is fit to do everything he has applied for, he would be entitled to a licence to do that. If not, there is a power for the OFT to issue him with a more limited licence.¹⁹ The previous system of five yearly licences was abolished in favour of a new system of indefinite standard licences with periodic payments to maintain the licence.

¹⁵ SI 2004 No. 2619

¹⁶ SI 2004 No. 3236

¹⁷ SI 2004 No. 3237

¹⁸ FSA regulated firms are already deemed 'fit' by definition

¹⁹ Sections 25(1) to (1AD) of the CCA 1974 as amended by clause 29 of the Bill

3. The financial crisis

The collective events known as the financial crisis which began in 2007 prompted a thorough review of all aspects of the financial regulation structure. Consumer credit, whilst not the main candidate in any sense for the cause of the crisis, was caught up in this review. Allied to this general rethink of regulation were specific issues connected with consumer lending. The biggest change is by virtue of the *Financial Services Act 2012*, as of April 2014, regulation of the consumer credit market passes to the Financial Conduct Authority. Regulation will henceforth be by FCA rules rather than by the less flexible structure of legislation. FCA 'Permission' will replace the old licensing system.

The Rule instrument can be found in Appendix 1 of the FCA Policy Statement 14/3 [here](#).²⁰

3.1 Comparing the FCA regime with the old OFT regime

Ethos and attitude

Whilst there are obvious changes between the technical details of the rules applied, also important will be the difference in attitude and culture of the two organisations. Although many of the same people and resources of the FCA are the same as those of the FSA it replaced, most observers note a more dynamic and intrusive style of regulation in operation. The FCA has made a point of stressing that it will be far more proactive in its work, rather than waiting for complaints to be brought to it. A feature of the OFT regime is that its history and culture is imbedded in the monitoring and regulation of competition issues and, to a lesser extent fair trading. By its nature this tended to be a more reactive and responsive body than the FCA *claims* it will be.

A rough guide to the new approach can be found in a speech by the FCA Director of Policy, Risk and Research in March 2014. It can be found [here](#). In it he highlighted two (of six) key principles supporting their rule based regulatory approach:

I want to quickly highlight two of the most important principles:

Principle six – which states that: 'a firm must pay due regard to the interests of its customers and treat them fairly'. This is usually called 'treating customers fairly'.

We've published half a dozen 'consumer outcomes' online to help explain what we want this principle to achieve. Cornerstones of this one are things like promoting clear information and ensuring the products sold to consumers are appropriate for them.

For those of you in compliance – and there are a few here today – there are also examples in the FCA Handbook of behaviours that are likely to contravene the treating customers fairly principle.

The other key principle to touch on is **principle three**: 'a firm must take reasonable care to organise and control its affairs

²⁰ FCA, [Detailed rules for the FCA regime for consumer credit](#), PS14/3 February 2014

responsibly and effectively, with adequate risk management systems'.

Broadly, this covers the following:

Robust governance arrangements

Skills, knowledge and expertise of staff

Outsourcing responsibilities

Record-keeping

Conflicts of interest

Clearly, the types of systems and controls a firm must have in place here reflect the nature, scale and complexity of the business, as well as the risk the activity might pose to consumers.²¹

The FCA has produced a [guide](#) to how its new rules will affect different sectors. Extracts from these are shown below.

Peer to peer platforms

This is to be regulated for the first time. This activity person 2 person (P2P) is called 'operating an electronic system in relation to lending'.

P2P platforms that make available consumer credit agreements already require a consumer credit licence from the OFT for debt administration.

They will now be regulated on other activities including:

- presenting the loan agreements to the lender and borrower;
- providing information to potential lenders about the financial standing of potential borrowers;
- collecting debts and administering the agreements facilitated by the platform; and
- providing credit information services (including credit repair).

Credit broking and intermediation

The current OFT regime, has two separate activities of:

- credit brokerage (introducing individuals to businesses that are lenders or other credit brokers)
- credit intermediation (certain other activities to arrange a loan)

Currently firms only doing credit intermediation, do not need an OFT licence. The new regime will bring together credit brokerage and credit intermediation in a single regulated 'credit broking' activity for which businesses will need to be authorised, so all firms will need to be authorised.

Third-party tracing agents

Provided a firm does no other activity for which it needs to be authorised a company whose business it is to trace the identity or location of a borrower or hirer of another company will be exempt from having to be authorised. Currently they do.

Credit reference agency

There will be a new activity of providing credit references that will replace the current activity of operating a credit reference agency. The

²¹ FCA website; Speech from Christopher Woolard; [Countdown to consumer credit takeover](#), March 2014

new activity only applies to a firm if its business **primarily** consists of providing others with information relevant to someone's financial standing and collecting such information for that purpose.

Consequently, only firms whose main business activity is being a credit reference agency are likely to meet the criteria to hold a permission for this activity.

Mail order agents

The current exclusion under the OFT regime of people like agents of mail order companies who canvass certain loan agreements during an unsolicited visit to a consumer's home is being widened to cover solicited visits and to include loans by a member of the same group as the supplier to finance the purchase of goods and services from the supplier.

Appointed representatives

Businesses may be exempt from authorisation if it has a contract with a firm (called 'the principal') that allows it to carry on certain activities under the permission of the principal. Various conditions apply to this exemption including:

- the firm that the business wants to act as its principal only holds an interim permission for the relevant credit activity
- it operates a credit reference agency
- it provides credit (unless the credit is free of interest and any other charges)
- it is authorised for another activity. However, the exceptions to this are:

a firm with an interim permission for a credit activity may also be an appointed representative for a FSMA regulated activity that is not covered by its interim permission

a firm with a limited permission for certain credit activities will be able to be an appointed representative for other regulated activities. e.g. a motor dealer with a limited permission to carry on credit broking can also be an appointed representative insurance intermediary

Insolvency practitioners

These will not be required to be authorised to do debt adjusting, debt counselling, debt collecting, debt administration and providing credit information services. Also, a person who carries on debt adjusting, debt counselling or providing credit information services in reasonable contemplation of appointment as an insolvency practitioner will be exempt.

Professional firms

Many professional firms currently carry on consumer credit activities under a group licence issued by the OFT. These include, for example, law firms and accountants.

Under the new FSMA regime, professionals who are members of certain professional bodies - such as the Institutes of Chartered Accountants and the Law Societies - may be able to carry on credit activities under supervision by their professional body, rather than by the FCA, as long

as the professional body has approved rules in place to regulate the carrying on of those activities by its members. If this is the case, the professional firm would not need to be authorised.

This applies, however, only if certain conditions are met, including that the consumer credit service provided by the professional firm is incidental to the professional services (i.e. non-regulated services) it provides. This is different to the group licensing regime and means that, if regulated credit activities are a major part of the practice of the firm (for example, a law firm whose primary business is debt collection), then this option is not available.

Cycle to Work Schemes

Employers participating in this will no longer need authorisation.

Not for profit bodies

This group includes the main national citizen advice bureaux. These currently operate under an OFT group licence and after April will be granted a limited permission authorisation for debt adjusting, debt counselling and providing credit information services.

The FCA has produced a helpful series of FAQs dealing with many aspects of the new authorisation regime. It can be found [here](#).

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