

Consumer Credit Regulation, the Financial Conduct Authority and CONC

By Lee Finch

Barrister, Gough Square Chambers

APPLICATIONS : APPROVED PERSONS : AUTHORISATION : COMPLIANCE :
CONDUCT OF BUSINESS SOURCEBOOKS : CONSUMER CREDIT : ENFORCEMENT
: FINANCIAL CONDUCT AUTHORITY

Summary: *An overview of the new regime of consumer credit regulation under the Financial Conduct Authority and a discussion of potential future developments.*

Background

The concept of “consumer credit” can be traced back to the 15th century. Ever since there have been legislative attempts to regulate the industry and protect the interests of consumers; the Act Against Usury 1552, the Money-lenders Act 1900, the Moneylenders Act 1927 and the Hire-Purchase Acts to name a few. However, in general terms, the modern law of consumer credit commenced with the Consumer Credit Act 1974 (“the 1974 Act”). The 1974 Act was introduced following the publication of the comprehensive Crowther Report in 1971¹ and replaced many of the existing statutes.

The 1974 Act was designed to be a flexible tool through which all forms of consumer credit and consumer hire, current and future, could be regulated. Accordingly, the regime under the 1974 Act evolved through the years with the introduction of amendments and subordinate legislation. Some of the changes made have been minor and gradual, some less so: some of the most significant changes were introduced in 2011 as the domestic regime was brought in line with the Consumer Credit Directive. Under the 1974 Act, the consumer credit industry was regulated by the Director General of Fair Trading and, later, the Office of Fair Trading (“OFT”); however, as part of the coalition government’s wide ranging reforms of the competition and consumer

¹ The Crowther Report contains a detailed discussion of the history of consumer credit regulation in the UK.

protection regimes, the OFT was abolished on 1 April 2014 and the Financial Conduct Authority (“FCA”) became the consumer credit regulator.

Regulation of consumer credit by the Financial Conduct Authority

The FCA came into existence in April 2013 as the successor agency to the Financial Services Authority and, as noted above, took over the regulation of consumer credit on 1 April 2014. This change is not simply one of name, there has also been a shift in the regulatory approach; regulation under the FCA will be different to regulation under the OFT from both an administrative and substantive perspective. Accordingly, creditors have had to undertake a significant amount of work in preparation for these changes, especially those who were not previously subject to FCA regulation.

All firms who fall under the new regime had to obtain “interim permission” before 1 April 2014. Any firm who failed to obtain interim permission by this date would no longer be able to carry on regulated consumer credit activities. In the two years following 1 April 2014, firms will need to apply for full permission in the “landing slot” allocated to them by the FCA. Again, a failure to obtain full permission by the necessary date will render firms unable to carry on regulated consumer credit activities by way of business: it is a criminal offence to carry on a regulated activity without the appropriate authorisation.² In addition to the administrative change from OFT licences to FCA permissions, it should also be noted that the reporting requirements are different and the FCA has different enforcement powers.

The high level principles that the FCA have adopted for the consumer credit regime also represent a significant development. In the first instance, firms are categorised according to the amount of potential harm that they could cause consumers and the level of regulation applied will then be appropriate to that risk: the FCA’s stated position is that it will focus on higher risk firms such as payday lenders, pawnbrokers and debt collectors and lower risk firms will be subject to less onerous obligations and will pay lower fees.

The substance of the regulatory regime has also been changed. No longer is there “simply” the 1974 Act and related secondary legislation. Instead there is an even more complicated plethora of regulation contained in a wide variety of sources; many sections of the 1974 Act have been repealed but a number of crucial sections remain;³ numerous amendments have been made to the Financial Services and Markets Act 2000 (“FSMA”) and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (“RAO”) to bring consumer credit regulation under

² See section 23 of the Financial Services and Markets Act 2000.

³ For example section 55 regarding disclosure of information, section 66A regarding withdrawal, sections 86B and 86C regarding notices of sums in arrears and sections 140A-140C regarding unfair relationships.

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the FSMA umbrella; and the FCA has, in line with its approach in other regulatory areas, introduced a Consumer Credit sourcebook (“CONC”). The remainder of this article will principally focus on the CONC sourcebook.

In July 2013, the FCA issued a consultation paper on its high-level proposals for the regulation of consumer credit.⁴ Subsequent to this consultation, a further consultation paper was issued in October 2013 which contained detailed draft conduct rules in the form of the proposed CONC sourcebook.⁵ Following the conclusion of the consultation process, the FCA published a policy statement which contained “final rules” on 28 February 2014.⁶ The new regime, including the CONC sourcebook, came into force on 1 April 2014. Firms can, however, take advantage of a “transitional period” until 1 October 2014 during which they will not contravene a CONC rule if they comply with the “corresponding rule” which applied on 31 March 2014.

The CONC Rules

Firms engaged in regulated consumer credit activity should, of course, read the CONC rules in detail and take legal advice if appropriate.⁷ However, the following provides a brief overview of the structure and content of the CONC rules.

CONC 1 sets out the application and purpose of the CONC rules and provides guidance on financial difficulties. In short, CONC applies to firms in respect of carrying on credit-related regulated activities; “credit related activities” is defined in the glossary to the FCA Handbook (with cross reference to the section 22 FSMA and the RAO) and includes entering into regulated credit agreements as lender or a regulated hire agreement as owner, exercising or having the right to exercise the lender or owners’ rights under such agreements, credit broking, debt adjusting, debt counselling, debt collecting, debt administration, providing credit information services, providing credit references, operating an electronic system in relation to lending and agreeing to carry on a regulated activity. Whilst CONC does not apply directly to a firm’s “appointed representatives”⁸, the FCA will treat the actions of appointed representatives as actions of the firm and, in reality, firms will have to ensure that their appointed representatives comply with CONC.

⁴ CP 13/7 (<http://www.fca.org.uk/static/fca/documents/consultation-papers/fsa-cp13-07.pdf>).

⁵ CP 13/10 (<http://www.fca.org.uk/static/documents/consultation-papers/cp13-10.pdf>).

⁶ PS 14/3 (<http://www.fca.org.uk/static/documents/policy-statements/ps14-03.pdf>).

⁷ The Perimeter Guidance Manual in the FCA Handbook provides a useful starting point when considering the scope and effect of the CONC provisions.

⁸ Defined in the glossary to the FCA Handbook with cross references to the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001.

CONC 2 contains rules and guidance surrounding business standards. These rules include, but are not limited to, a reiteration of Principle 6⁹ requiring firms to treat customers fairly, restrictions on the provision of credit card cheques, requirements governing the disclosure of credit reference agencies used and the prohibition of unsolicited credit tokens. Existing obligations under other legislation are also now incorporated into CONC 2: CONC 2.7 covers distance marketing and is principally derived from the Financial Services (Distance Marketing) Regulations 2004 whilst CONC 2.8 covers E-commerce and is principally derived from the E-Commerce Directive.¹⁰ Finally, there are specific rules governing business standards for credit broking, debt counselling, debt adjusting and providing credit information services and guidance on mental capacity.¹¹

CONC 3 governs financial promotions made by firms. “Financial promotion” is defined in the glossary to the FCA Handbook as “an invitation or inducement to engage in investment activity¹² that is communicated in the course of a business”. There are a number of detailed rules, however it is an overarching requirement that firms ensure that financial promotions are clear, fair and not misleading (CONC 3.3). Other notable rules include CONC 3.4 governing the mandatory risk warning on high-cost short-term credit,¹³ CONC 3.7 regarding the disclosure of a credit broker’s status and CONC 3.11 prohibiting the approval of certain financial promotions. As with many other sections of CONC, significant sections of CONC 3 are derived from existing requirements.¹⁴

CONC 4 sets out detailed pre-contract requirements including the content of quotations,¹⁵ adequate explanations, details relating to continuous payment authorities, and specific requirements for brokers including commission disclosure. These requirements do not replace but work alongside the pre-contractual requirements contained in the disclosure regulations¹⁶ made under section 55 of the 1974 Act.

CONC 5 details the FCA’s rules on responsible lending. These rules effectively replace section 55B of the 1974 Act and the OFT’s Irresponsible Lending Guidance; accordingly, there are detailed rules and guidance on pre-contract creditworthiness assessments. Particular regard

⁹ See PRIN 2.1.1 R in the FCA Handbook.

¹⁰ Directive 2000/31/EC.

¹¹ See previously the OFT’s Mental Capacity Guidance.

¹² Further defined to include the regulated credit activities discussed above.

¹³ Broadly, unsecured lending to be repaid within 12 months with an APR equal to or in excess of 100%.

¹⁴ For example, existing requirements in the 1974 Act and the Consumer Credit (Advertisements) Regulations 2010.

¹⁵ Derived from the Consumer Credit (Content of Quotations) and Consumer Credit (Advertisements) (Amendment) Regulations 1999.

¹⁶ The Consumer Credit (Disclosure of Information) Regulations 2010 which principally introduced the requirements mandated by the EU Consumer Credit Directive.

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should be had to the rules setting out unfair business practices which include not basing the creditworthiness assessment primarily or solely on the value of any security provided by a customer (CONC 5.3.4R) and not accepting an application where the firm knows or ought reasonably to know that the customer has not been truthful in providing the information on which it will base its creditworthiness assessment (CONC 5.3.7R).

CONC 6 sets out detailed rules relating to post contractual requirements. These requirements include conducting a creditworthiness assessment before significantly increasing the amount of credit or credit limit, providing information to customers who significantly overdraw on their account without prior agreement, the manner in which payments should be appropriated, obligations regarding notices of assignment and specific rules relating to credit broking and pawn broking. As explained above in relation to CONC 3, many of these rules derive from pre-existing legislation and guidance.

CONC 7 contains many detailed requirements covering what can be generally termed “recoveries”. The vast majority of CONC 7 is derived from the OFT’s Irresponsible Lending Guidance and Debt Collection Guidance; however, as discussed below, it should be borne in mind that some of these guidelines have been elevated to the status of rules. For obvious reasons, it is not possible to analyse each element of CONC 7 in this article, however it is worth highlighting some important rules: firms must not take action to repossess a customer’s home other than as a last resort, having explored all other options (CONC 7.3.17R); once a customer disputes a debt, a firm must not continue to make demands for payment without providing clear justification and/or evidence as to why the customer’s claim is not valid (CONC 7.5.3R); and a firm must not claim the costs of recovering a debt from a customer if it has no contractual right to claim such costs (CONC 7.7.2R)¹⁷.

CONC 8 governs debt counselling, debt adjusting and, to a certain extent, providing credit information services. Notably, CONC 8 requires debt management firms to signpost sources of free advice (CONC 8.2.4R), mandates certain pre-contractual information that must be disclosed in a durable medium (CONC 8.3.1R) and requires firms to ensure that its fees and charges do not have the effect that its customer pays all or substantially all of its fees in priority to making repayments to lenders (CONC 8.7.2R).

¹⁷ The author does, however, consider that such costs could be claimed/recovered as a loss resulting from a breach of contract under normal common law principles (irrespective of whether the credit agreement between the parties provided a specific obligation on the customer to pay such costs).

CONC 9 sets out rules for credit reference agencies regarding the correction of entries in their files. The rules govern the information which the credit reference agency must provide to relevant parties¹⁸ following the amendment or correction of an individual's credit file.

CONC 10 contains prudential rules for debt management firms. In simple terms, the requirement is for debt management firms to maintain prudential resources of £5,000 or the sum of 0.25% of the first £5 million of debts under its management and 0.15% of the next £95 million and 0.05% of the remaining debts under management, whichever is higher.

CONC 11 provides customers with a right to cancel certain distance contracts within 14 days without penalty. The CONC 11 cancellation right does not, however, apply to agreements covered by the right of withdrawal under section 66A of the 1974 Act, credit agreements secured by a legal mortgage on land, credit agreements cancelled under regulation 15(1) of the Consumer Protection (Distance Selling) Regulations 2000 or credit agreements cancelled under regulation 23 of the Timeshare, Holiday Products, Resale and Exchange Contracts Regulations 2010. There is no exemption for credit agreements still covered by section 67 of the 1974 Act and CONC 11.1.3 G indicates that customers can elect whether to cancel under CONC 11 or section 67.¹⁹

CONC 12 sets out rules for firms with interim permission for credit related activities. The rules in CONC 12 disapply and modify certain sections of the FCA Handbook to ensure that they are suitable for firms who have interim permission rather than full permission.

CONC 13 provides guidance on firms' obligations under sections 77, 78 and 79 of the 1974 Act. CONC 13 effectively replaces the OFT's guidance on those sections and represents the FCA's attempt to summarise the statutory requirements and relevant case law relating to copy agreements under those sections.

CONC 14 details requirements relating to agents. Firms must not appoint agents who are not authorised or exempt persons unless the individual will only act as agent for that firm (and no other firm), there is a written contract with the agent setting out effective measures of control and requiring the agent to disclose that he is representing the firm to customers and the firm accepts full responsibility for the conduct of the individual acting as agent.

Finally, CONC 15 addresses second charge lending. Many of these rules are aimed at supporting and supplementing firms' other obligations under CONC and other legislation. For example, firms are required to encourage customers to read all contractual documentation carefully and encourage customers to obtain independent advice (CONC 15.1.8R).

¹⁸ Those to whom it has provided information regarding an individual's financial standing.

¹⁹ The author notes, however, that this guidance is misguided. CONC 11 only applies to distance contracts and such contracts do not fall within the definition of "cancellable agreements" in section 67 of the 1974 Act; accordingly, the two cancellation rights cannot apply concurrently.

Points to note for firms governed by the new regime

Aside from the administrative issues that firms currently have to deal with, there are numerous substantive changes and issues that arise from the new CONC rules which firms will need to consider.²⁰ It is outside the scope of this article to consider all the problems that the new rules may create for those governed by them but it is worth addressing a few examples.

One of the most significant changes from the old regime is the “elevation” of certain OFT guidance to rules. When the draft CONC rules were published in October 2013, many provisions that had been transferred from the OFT guidance documents had been elevated to rules. This, unsurprisingly, was opposed by the credit industry and the responses to consultation reflected this. The FCA reacted by making a number of alterations when the final rules were published, downgrading a number of provisions to the status of guidance.²¹ On the other hand, the FCA refused to downgrade a number of CONC rules despite objections. For example, there is now a prescriptive rule (CONC 4.2.15R) requiring disclosure of information above and beyond the adequate explanation requirements of CONC 4.2.5R in the case of certain types of agreement²² and firms are now obliged to consider certain factors when conducting the creditworthiness assessment when, previously, it was only suggested through guidance (CONC 5.2.1R).

It is also noteworthy that in “elevating” guidance to rules, the FCA has brought some of the CONC provisions into potential conflict with existing Regulations derived from European Directives. For example, CONC 6.7.14R (preventing interest rate increases without a valid reason, even in contracts of indeterminate duration) goes beyond the Unfair Terms in Consumer Contracts Regulations 1999 which do not prevent unilateral alterations in contracts of indeterminate duration provided the supplier is required to inform the consumer within a reasonable time and the consumer is free to dissolve the contract. Perhaps more crucially, CONC 5.2.1R (discussed above) goes beyond section 55B of the 1974 Act and is in potential conflict with the Consumer Credit Directive through the inclusion of “affordability”. The credit industry argued that this amounted to the gold plating of a maximum harmonisation Directive but the FCA disagreed, pointing to the “margin of manoeuvre”. This may form the subject of future litigation but, at present, firms should be aware that there are additional requirements in

²⁰ Especially as the transitional period, under which compliance with the old rules was sufficient, ends on 30 September 2014.

²¹ See, for example, CONC 4.2.2G, 4.2.7G, 5.2.3G and 5.3.3G.

²² Including credit token agreements, bill of sale loan agreements, hire purchase and conditional sale agreements.

CONC beyond those that they were previously complying with under Consumer Credit Directive derived legislation.

As stated above, CONC is principally derived from existing legislation, rules and guidance. Nevertheless, there are some rules which are not straightforward to understand and implement. For example, CONC 8.2.7R requires firms to establish “clear and effective policies and procedures to identify particularly vulnerable customers and to deal with such customers appropriately” but neither “vulnerable customers” nor “particularly vulnerable customers” are defined.

Potential future developments

Within the FCA’s policy statement there is a clear focus on “high-cost-short-term” credit, continuous payment authorities and debt management and it is likely that further developments, including the focus of enforcement actions, are likely to fall in these areas.

One of the most significant developments facing firms is the introduction of a price cap on high-cost-short-term credit in January 2015.²³ The FCA issued a consultation paper on 15 July 2014²⁴ setting out its proposals in relation to the cap. The FCA’s proposals can be summarised as a limit of 0.8% per day interest, a limit of £15 on default fees and an overall cost cap (for interest and fees) of 100% of the amount borrowed. Needless to say, the cap is going to have a substantial impact on the high-cost-short-term credit industry and the action taken by the FCA in response to the feedback received during the consultation period²⁵ is eagerly anticipated.

As noted above, there could also be legal challenges to a number of the CONC rules and, even if there are not, further changes should not be discounted.²⁶ Like much of the FCA handbook, the CONC rules will be an ever evolving beast which will require constant vigilance. After all, some minor amendments have already been made to the “final” rules.²⁷

²³ The FCA are under a duty to introduce such rules by virtue of subsection 1(a)(ii) and (b) of section 137C FSMA.

²⁴ CP 14/10.

²⁵ Which ended on 1 September 2014.

²⁶ The FCA has indicated that they may review in the future whether CONC 4.2.2G should be applied as rules to all regulated agreements.

²⁷ For example, CONC 15.1.6G was amended on 1 July 2014.