GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: AUGUST 2015

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In the August column, James Ross considers certain issues arising under the current consumer credit regulatory regime, highlighted by recent litigation, which could potentially be addressed by the FCA review of retained provisions in the Consumer Credit Act 1974 (CCA).

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FCA REVIEW OF RETAINED PROVISIONS OF THE CONSUMER CREDIT ACT 1974

Background

On 1 April 2014, consumer credit regulation transferred from the Office of Fair Trading (OFT) to the FCA. The implementation timetable was tight and firms had a relatively short period to adapt their processes to comply with the new FCA rulebook (the Consumer Credit sourcebook (CONC)), the FCA's Principles for Business (PRIN), and a wide range of other new requirements covering governance, data reporting, systems and controls.

To reduce the challenges faced by firms in adapting their systems to yet another significant change to their regulatory environment, the aim was for the substance of the new rules to mirror the existing requirements and guidance under the old OFT regime. This meant that large parts of the Consumer Credit Act 1974 (CCA), subsidiary legislation and OFT guidance were moved into CONC, with substantial amendments also being made to the Financial Services and Markets Act 2000 (FSMA) and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (*SI 2001/544*) (RAO). (For an overview of CONC, see *Practice note, FCA consumer credit regulation: overview of Consumer Credit sourcebook (CONC) (www.practicallaw.com/7-549-4106)*.)

However, the transfer to the FCA has left consumer credit regulation in a state where it is unnecessarily complex and inaccessible for anyone coming to the area for the first time. In recognition of this, Part 5 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2014 (RAO Amendment Order) requires the FCA to undertake a review of the CCA and make a report to HM Treasury by 1 April 2019. The review under Part 5 of the RAO Amendment Order will, in particular, consider whether the remaining provisions of the CCA could be replaced by rules or guidance made by the FCA under FSMA. The FCA's report may make recommendations relating to the exercise by HM Treasury of its powers, under section 107 of the Financial Services Act 2012, to repeal provisions of the CCA.

This month's column considers certain issues arising under the current regulatory regime, highlighted by recent litigation, which could potentially be addressed by the FCA review of retained provisions in the CCA.

Post-contractual statements and notices

Some of the most important issues currently faced by consumer credit firms arise in relation to CCA post-contractual statements of account (section 77A, CCA) and arrears notices (sections 86B, 86C and 86D, CCA).

The content requirements for such statements and notices, set out in the Consumer Credit (Information Requirements and Duration of Licences and Charges) (*SI 2007/1167*) (2007 Regulations), are highly complex and arguably the prescribed information is not particularly helpful to customers in any event. More importantly, the CCA sanctions for non-compliance with the 2007 Regulations are harsh: the underlying credit agreement is unenforceable during the period of non-compliance and the customer has no liability to pay interest or default charges relating to the period of non-compliance.

Regulation 41 of the 2007 Regulations effectively provides that any error or omission which does not affect the substance of the information or wording in a statement or notice does not amount to a breach. However, the court in *JP Morgan v Northern Rock [2014] CTLC 33* confirmed that if a breach does not fall within regulation 41, the statutory statement or notice is entirely ineffective; it is as if no statement or notice had been given at all (for more information, see *Legal update, High Court considers whether a non-compliant statement is still a statement under section 77A of the CCA (www.practicallaw.com/2-572-9305)*).

This binary "all or nothing" approach leaves firms in a difficult position when faced with issues of potential documentary non-compliance: there is little or no guidance from the courts or the FCA as to which defects fall within the scope of regulation 41, or how any redress exercise involving refunds and issuing remedial paperwork should be carried out. Critically, if the firm fails to remedy the breach by issuing compliant paperwork to customers, the period of non-compliance will continue and the interest to be refunded will continue to increase in the interim. It is easy to argue that such a sanction is inappropriate and contrary to the principles underlying FCA regulation: customers potentially receive a substantial windfall in relation to minor errors or omissions which may have caused them no detriment at all.

This issue arose particularly starkly in the recent case of *NRAM plc v McAdam and another [2015] EWCA Civ 751*, where at first instance it was held that NRAM was liable to make refunds to customers under section 77A of the CCA where the underlying credit agreements had been incorrectly documented as CCA-regulated agreements. This was even though the loans exceeded the historic monetary limit of £25,000 such that they were not in fact regulated under the CCA. Fortunately for NRAM, this decision was overturned by the Court of Appeal, holding that the parties cannot "contract in" to the CCA regime (for more information, see *Legal update, Court of Appeal restores commercial sense in NRAM plc v McAdam and another (www.practicallaw.com/1-617-6484)*). Nevertheless, the case underlines the potential harshness of the CCA regime when it applies.

The CCA unenforceability sanction

The historic regulatory regimes under FSMA and the CCA both made use of the unenforceability sanction in relation to agreements falling within their respective regulatory perimeters. However, the CCA regime was more wide-ranging in its use of the sanction. Under FSMA, the unenforceability sanction was generally reserved for firms that were carrying on activities without appropriate authorisation or permission (see the current versions of sections 26 and 26A of FSMA). Regulated firms therefore did not face the unenforceability sanction, but were required to comply with the applicable FCA rules and were potentially subject to the FCA's extensive disciplinary powers.

The CCA imposed a similar sanction relating to unlicensed creditors (section 40, CCA), but even creditors who held the appropriate OFT licence could see their agreements rendered unenforceable by numerous other CCA provisions relating to pre-contract information, agreement documentation and post-contractual statements and notices (sections 55, 61, 65, 77A and 86D, CCA). Most of those parts of the CCA have been retained. Consumer credit firms therefore now face a situation where they are still subject to the rigours of the CCA regime, but must also incur the costs associated with FCA regulation under FSMA.

The solution?

An indication of the most straightforward solution to the problems identified above can perhaps be seen in the FCA rules (for example CONC 7.17, which relates to notices of sums in arrears given under peer to peer agreements). These FCA rules impose similar content requirements to the 2007 Regulations but the sanction for breach is the same as for any other FCA handbook rule: the FCA can have recourse to its usual range of disciplinary powers and the breach is actionable as a breach of statutory duty under section 138D of FSMA to the extent that any loss has been caused to the customer. This allows firms and the FCA to take a more nuanced and proportionate response in relation to compliance issues that can take account of actual customer detriment. There is no automatic requirement to refund interest and the spectre of unenforceability does not arise. There is a good argument that all of the documentary requirements imposed by or under the CCA would now be better placed within CONC for these reasons.

Consumer groups will naturally be keen to ensure that any rule-based alternatives developed by the FCA to replace the retained CCA provisions offer strong protection for consumers. However, there is no reason why the level of information to be provided to consumers cannot be maintained or even enhanced under FCA rules.

A *draft briefing paper (http://www.fla.org.uk/main-data-content/files/2014/redirect/765gjtY/submo_776yietRWTREYYGUGIHI_87/Consumer-Credit-Act-2019-Review-Draft-FLA-Briefing-4-June-2015.pdf)* has recently been published by the Finance and Leasing Association (FLA) that raises a number of important issues to consider as part of the FCA review. More difficult decisions will need to be made relating to those parts of the CCA that will be more awkward to fit within the FCA regime under FSMA, such as deemed agency under section 56 of the CCA, connected lender liability under section 75 and the provisions relating to judicial control in Part IX of the CCA. The consultation process in relation to those issues will take some time but it would be unfortunate if the current unsatisfactory position relating to CCA documentation was not addressed until some time after 1 April 2019.