

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: AUGUST 2017

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James Ross, Ruth Bala, Thomas Samuels and Lee Finch are all specialist consumer credit counsel at Gough Square Chambers. On a regular basis, they will share their views with Practical Law Financial Services subscribers on topical developments or key issues relating to consumer credit.

In the August column, Lee Finch provides an overview of the key FCA rules and guidance that apply in the high-cost short-term credit (HCSTC) market and considers the FCA's current work that could lead to changes in this field.

by *Lee Finch, Gough Square Chambers*

HIGH-COST SHORT-TERM CREDIT

Background

The “pay day lending” or high-cost short-term credit (HCSTC) market has been a hot topic since before the FCA took over regulation of consumer credit from the OFT in April 2014. However, it was only when the FCA started preparations for the regime transfer that detailed rules specific to this expanding market were proposed and, ultimately, adopted.

When the FCA consulted on its proposed new Handbook chapter for consumer credit, the Consumer Credit sourcebook (CONC), it included proposals for the HCSTC market that, with some amendments, were introduced on 1 April 2014. These new rules included, inter alia, a requirement for a risk warning, restrictions on continuous payment authorities (CPAs), a limit on the number of times that a loan can be rolled over, an obligation to assess the potential for the loan to adversely impact the customer's financial situation, and a requirement to inform customers about sources of debt advice before refinancing a loan.

While the FCA was in the process of developing these rules, Parliament imposed a duty on the FCA to secure an appropriate degree of protection from excessive charges for borrowers of HCSTC (see section 137C(1) of the Financial Services and Markets Act 2000 (FSMA)). Consequently, the FCA consulted on a proposed price-cap and subsequently introduced rules implementing the proposed price cap. The price cap has been in place since 2 January 2015.

The remainder of this column provides an overview of the key rules that apply in the HCSTC market and considers the FCA's current work, which could see changes in this field.

What is high-cost short-term credit?

The Consumer Credit (Consequential and Supplementary Amendments) Instrument 2014 (FCA 2014/12) introduced the following definition of HCSTC into the FCA Handbook Glossary:

RESOURCE INFORMATION

RESOURCE ID

w-009-7128

RESOURCE TYPE

Article

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JURISDICTION

United Kingdom



High-cost short-term credit

A regulated credit agreement:

- Which is a borrower-lender agreement or a P2P agreement;
- In relation to which the APR is equal to or exceeds 100%;
- Either:
 - in relation to which a financial promotion indicates (by express words or otherwise) that the credit is to be provided for any period up to a maximum of 12 months, or otherwise indicates (by express words or otherwise) that the credit is to be provided for a short term; or
 - under which the credit is due to be repaid or substantially repaid within a maximum of 12 months of the date on which the credit is advanced;
- Which is not secured by a mortgage, charge or pledge; and
- Which is not:
 - a credit agreement in relation to which the lender is a community finance organisation; or
 - a home credit loan agreement, a bill of sale loan agreement or a borrower-lender agreement enabling a borrower to overdraw on a current account, or arising where the holder of a current account overdraws on the account without a pre-arranged overdraft or exceeds a pre-arranged overdraft limit.

The FCA considered expanding this definition when it consulted on introducing the price cap but decided to retain its original definition. Accordingly, certain forms of high-cost credit such as home collected credit, pawn broking, logbook loans, overdrafts and running account agreements (that is, credit cards) are excluded from the definition and, consequently, the rules and restrictions on HCSTC. This approach has been criticised as inconsistent and unjustified; nevertheless, following its recent review of the high-cost credit market, in FS17/02 the FCA states that it has decided against expanding the definition on the grounds that there had not been any significant attempt by firms to manipulate their products to avoid falling within the definition of HCSTC (for more information on FS17/02, see [Future developments](#) below).

What are the rules applying to high-cost-short-term credit?

Price cap

Subject to certain transitional provisions, the price cap for HCSTC was introduced on 2 January 2015 via an amendment to the FCA handbook, which introduced Chapter 5A to CONC. The cap can be broken down into three distinct restrictions that apply cumulatively:

- **The total cost cap.** Under CONC 5A.2.2, borrowers must never have to pay more in fees, interest and charges than 100% of what they borrowed.
- **The initial cost cap.** Under CONC 5A.2.3, when loans are taken out or rolled over the interest, fees and charges which the borrower is required to pay must not exceed 0.8% per day of the amount borrowed.
- **The default cost cap.** Under CONC 5A.2.14, default fees must not exceed £15. Firms can continue to charge interest after default but this must not exceed the initial interest rate charged (see section 93 of the Consumer Credit Act 1974 (CCA)).

The consequences of breaching any of these caps are set out in CONC 5A.5.2 and include the following:

- The agreement is unenforceable against the borrower.
- The debtor can choose not to perform the agreement and recover all charges paid to the lender (although the borrower must then repay the credit).

Risk warning

In addition to complying with the usual financial promotions requirements contained in CONC 3, financial promotions relating to HCSTC must also include a "risk warning". The FCA initially proposed the following risk warning:

"Think! Is this loan right for you?

Over 2 million short-term loans were not paid off on time in 2011/2012. This can lead to serious money problems.

If you're struggling, go to www.moneyadvice.service.org.uk for free and impartial help."

There was significant opposition to this proposed warning. The principal criticisms were that the warning was too long, ineffective and inappropriate. In response to these concerns, the FCA amended the risk warning to make it shorter and sharper in the final rules. The current risk warning in CONC 3.4.1 reads:

"Warning: Late repayment can cause you serious money problems. For help, go to moneyadvice.service.org.uk".

It should be noted that the website address can be substituted for the Money Advice Service's logo but, whichever version is used, the risk warning must be included in the financial promotion in a prominent way.

Rollovers

Under CONC 6.7.20, before a firm agrees to refinance or "rollover" a HCSTC agreement, it must send the borrower an information sheet and, where reasonably practicable, bring that information sheet to the attention of the borrower. The information sheet that must be provided follows the form of the arrears information sheet referenced in section 86A of the CCA with a variety of modifications. These include the following warnings (with further modifications for lenders operating electronic systems):

- "Think carefully - rolling over or extending your loan may not be the best option and may make things worse."
- **"Think carefully before borrowing more.** Borrowing more money is likely to worsen your situation."
- **"Work out how much you owe..."**
- **"Put priority debts first..."**
- **"Discuss options with your lender..."**
- **"Get free help and advice..."**

Firms should also refrain from refinancing HCSTC where to do so would be unsustainable or otherwise harmful for the borrower (CONC 6.7.21), and should not allow borrowers to enter into consecutive HCSTC agreements if the cumulative effect is that the total amount payable is unsustainable (CONC 6.7.22).

Under CONC 6.7.23, firms are prohibited from refinancing HCSTC on more than two occasions.

Continuous payment authorities

In addition to complying with the general rules on CPAs in CONC 7, a firm providing HCSTC is also precluded from using a CPA to collect any sums due under a HCSTC agreement if it has already attempted to do so twice and those previous payment requests have been refused (CONC 7.6.12(1)).

Where a HCSTC agreement has been refinanced, it is treated as the same agreement for the purpose of calculating the number of CPA requests made.

Once the limit has been reached, a borrower (once reminded of the characteristics of the CPA - the matters listed in CONC 4.6.2(2)) can "reset" the CPA by giving explicit consent for the firm to continue exercising rights under the CPA (CONC 7.6.12(5)).

Future developments

The rules that apply to HCSTC have now been in place for a little over three years (two and a half years in the case of the price cap).

The FCA committed, in its policy statement setting out the final price cap rules (PS14/16), to reviewing the HCSTC price cap in the first half of 2017. In the light of wider issues surrounding the high-cost credit market (including, but not limited to, the highly publicised criticism that other forms of credit can be more expensive than HCSTC), the FCA issued a call for input that went beyond simply reviewing the price cap and considered high-cost credit more widely. The wider scope of the FCA's review also reflects the holistic approach that the FCA is currently adopting in its work involving the retail banking and credit industry (emphasised in FCA Chief Executive Andrew Bailey's speech to the British Banking Association on 29 June 2017, see [Legal update, FCA speech on conduct regulation in retail banking](#)).

The FCA published its response (FS17/2) to the call for input on 31 July 2017 (see [Legal update, FCA feedback statement on high-cost credit market](#)). It decided against amending the definition of HCSTC or increasing the price-cap, but committed to reviewing its position again in 2020.

In terms of the wider high-cost credit market, the FCA identified a number of issues that it considered may cause consumer harm (notably in respect of rent-to-own products, home-collected credit, catalogue credit and overdrafts). The FCA will investigate these issues further and, should it conclude that intervention is justified, will consult on proposed rules and guidance in spring 2018. While it is too early to say whether the FCA will take action, it is likely that any steps it does take will dovetail with its wider work; including, for example, the FCA's ongoing consultations on persistent debt (CP17/10) and staff incentives (CP17/20) (see [Legal updates, FCA consults on persistent credit card debt and earlier intervention remedies](#) and [FCA consults on staff incentives and performance management in consumer credit firms](#)).

For more information on the high-cost credit market, see [Practice note, Payday lending and other high-cost credit activities](#).

Gough Square Chambers' consumer credit columns

For previous consumer credit columns written by barristers at Gough Square Chambers, see [Practice note, Gough Square Chambers' consumer credit columns](#).