

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: JUNE 2018

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In the June column, Thomas Samuels considers the impact of the FCA's recent high-cost credit review.

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IMPACT OF THE FCA'S HIGH-COST CREDIT REVIEW

Introduction

On 31 May 2018, the FCA published the outcome of its high-cost credit review and has now embarked upon consultation with consumer bodies and the lending industry to determine next steps. This column summarises the FCA's findings and the likely consequences of the current proposals.

Outcome of the review

The FCA's review was concerned with four specific types of what it termed "high-cost" credit:

- Rent-to-own (RTO) agreements on household goods, including extended warranties.
- Home-collected credit.
- Catalogue credit and store cards.
- Overdrafts (with particular focus on unarranged overdraft fees).

Beyond identification of those four types of credit, the FCA does not appear to have specifically defined what constitutes high-cost credit. However, the Glossary to the FCA Handbook currently defines "high-cost short-term credit" (HCSTC) by reference to an annual percentage rate (APR) exceeding 100%.

The overarching intention behind the review is to reduce costs for consumers and "give them greater control over their finances", in particular on the basis that high-cost credit is more likely to be taken by vulnerable consumers without access to other sources of finance. The FCA estimates that its proposed reforms may generate up to £200 million of annual savings for consumers.

More complete information about the outcome of the review and the FCA's next steps is available in consultation papers *CP18/12 (High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing)* and *CP18/13 (High-cost Credit Review: Overdrafts)*. In summary, however, the following points are made in relation to each of the four types of high-cost credit considered:

- **RTO credit.** Agreements typically consist of the base price of the product, the interest and other costs of the credit, plus any additional insurance or warranties. Although classed as "high cost", the FCA considers that the APR of RTO credit is a poor indicator of cost because the base price of the item is often above market value. The regulator's view is that a price cap may be appropriate, in addition to enhanced disclosure and risk warnings. A blanket prohibition on point-of-sale warranties is also under consideration.



- **Home-collected credit.** This is in many respects similar to payday lending, save that repayments are collected weekly from the consumer at home. The FCA's research showed consumers were "mainly positive" about such credit. However, it considers that this attitude may contribute to vulnerability, as such loans are expensive and often taken repeatedly. Certain practices of such lenders were identified as breaching section 49 of the Consumer Credit Act 1974 (CCA), which prohibits soliciting off-trade premises without written permission. Additional rules about the risks of refinancing and repeat borrowing have been suggested.
- **Catalogue credit and store cards.** These are "running account" agreements (as defined by section 10 of the CCA), which enable consumers to buy goods and services on credit. They were identified for review because of the high levels of arrears, and fees and charges. The FCA's findings highlighted the lack of consumer information, a lack of control over credit limit increases and the risk of persistent debt. It is proposing to extend the rules at section 6.7 in the Consumer Credit sourcebook (CONC) to cover catalogue credit and to put in place specific rules about extending credit limits for customers in financial difficulties. In relation to persistent debt, the FCA is considering rules to prompt customers to repay more quickly and/or to seek help, with specific interventions by the lender after 18, 27-8 and 36 months.
- **Overdrafts.** These form the bulk of the FCA's review and are covered exclusively by CP18/13. Generally, the regulator's concern is that overdrafts are poorly understood by many consumers. They can be subject to substantial fees payable by a small minority of banking customers. The proposed reforms to overdrafts are extensive but, broadly, tackle four areas of concern:
 - a lack of consumer awareness;
 - the complexity of pricing;
 - the high level of fees; and
 - repeated use of overdraft facilities.

In particular, it is proposed that mandatory mobile alerts be introduced in relation to potential charges, the cost of an overdraft be expressed as a single APR, and a ban or cap on unauthorised overdraft fees.

Issues to consider

The target areas of the review and the proposals which have now been published by the FCA, illustrate the on-going focus on the provision of information to consumers, the cost of credit and the risk of persistent debt. There is clearly regulatory concern about how these factors combine to create vulnerability within certain categories of borrower.

The final rules and guidance that emerge from the review are yet to be seen. However, it is likely that they broadly follow the proposals set out in CP18/12 and CP18/13. Nonetheless, at this mid-point in the reform process, the FCA's attitude towards overdrafts is of particular interest; specifically, in light of the decision of the Supreme Court in the so-called "Bank Charges" litigation (*Office of Fair Trading v Abbey National plc & Ors* [2010] 1 AC 696).

As is well-known, the Bank Charges litigation concerned a challenge by the OFT (who regulated consumer credit before the FCA) in relation to the fairness of unauthorised overdraft charges under the Unfair Terms in Consumer Credit Regulations 1999 (*SI 1999/2083*) (UTCCRs). The OFT successfully argued up to the Court of Appeal ([2009] 2 WLR 1286), that such charges were amenable to challenge as unfair terms; although the UTCCRs did not permit challenges in relation to the price of goods or services, the scope of that carve-out was limited to items which constituted the main subject matter of the contract, whereas overdraft charges were incidental or ancillary to the package of banking services. However, to the surprise of many, that analysis was rejected on appeal to the Supreme Court, which instead concluded that any monetary price fell within the carve-out. As such, neither the OFT nor an individual consumer could seek to challenge the level of unauthorised overdraft charges.

The UTCCRs were replaced by Part II of the Consumer Rights Act 2015 (CRA) for agreements entered into from 1 October 2015. However, section 64(1) of the CRA provides for a materially identical carve-out to the relevant provision of the UTCCRs. Indeed, both provisions exist to implement Article 4(2) of the Unfair Terms Directive (93/13/EC). Thus, the Supreme Court's analysis in the Bank Charges litigation will be equally applicable to the current position under the CRA.

The consequence of all of the above is that a ban on such charges by the FCA will - directly or indirectly - be in conflict with primary legislation that has been interpreted by the Supreme Court as permitting them. As such, if

the banking industry has an appetite for it, the FCA may well face judicial review proceedings seeking to quash the introduction of such rules and guidance. Presumably these would be along similar lines to the challenge in *R (on the application of British Bankers Association) v Financial Services Authority* [2011] Bus LR 1531, where it was argued that amendments introduced to the rules governing customer complaints relating to payment protection insurance (PPI) mis-selling were unlawful.

Certainly, the FCA is aware of the risk of such a challenge. Despite pressure from consumer charities to act swiftly, the FCA's Chief Executive, Andrew Bailey, was quoted as stating that the regulator wants to avoid a "screw up" in light of the Bank Charges decision ("Watchdog criticised over 'disappointing' action on high-cost credit", The Guardian, 31 May 2018).

Conclusion

In light of the review, substantial reforms in relation to high-cost credit must be expected later in 2018. These are likely to be implemented by further amendments to the CONC section of the FCA Handbook. However, there is a chance that a cap on overdraft charges will simply sound the starting gun on the Bank Charges litigation, part two.

For more information on the FCA's high-cost credit review, see [Practice note, Payday lending and other high-cost credit activities: FCA review of high-cost credit](#).

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