

Guidance consultation

GC 16/2: Proposal to issue guidance on the FCA's view of enforcing security under the Consumer Credit Act 1974

Guarantor loans – default notices

February 2016

1 Introduction

- 1.1 Under section 139A of the Financial Services and Markets Act 2000 (FSMA), the Financial Conduct Authority (FCA) may give guidance that consists of any information and advice it considers appropriate to matters relevant to our functions.
- 1.2 Where such guidance does not relate to FCA rules, the procedural requirements in section 138I of FSMA do not apply and we do not have to consult on draft guidance. However, we are inviting views in this case before finalising the guidance as the interpretation of what is enforcement in relation to security will impact on the circumstances in which a firm could breach the Consumer Credit Act 1974 (CCA).
- 1.3 This document constitutes proposed guidance with respect to the operation of the CCA, and in particular the requirement in section 87 to serve a default notice before taking certain actions following breach of a regulated agreement.
- 1.4 The guidance relates to guarantor loans, under which an individual other than the borrower provides a guarantee or indemnity (or both) in relation to a regulated credit agreement or a regulated consumer hire agreement.
- 1.5 The guidance also updates our view on the need for a default notice in certain circumstances as set out in PS15/23 published in September 2015.

2 Guarantor loans – default notices

Purpose of document

2.1 We are publishing this document as general guidance to consumer credit firms.

The statement in PS15/23

2.2 In February 2015, the FCA published a consultation on proposed changes to our consumer credit rules and guidance, including in relation to guarantor loans.¹

2.3 We published a feedback statement and final rules and guidance in September 2015 (PS15/23).² The changes included an addition to the Principles for Businesses (PRIN) and new provisions in the Consumer Credit sourcebook (CONC) in relation to:

- adequate pre-contract explanations,
- continuous payment authorities (CPAs),
- creditworthiness assessments, and
- arrears, default and recovery.

2.4 We noted in Chapter 3 of PS15/23 that some respondents had suggested possible further rules on guarantor lending. For example, some argued that firms should not be permitted to take money from a guarantor using a CPA, or should be required to provide prior warning or a default notice. Respondents also suggested that firms should not be permitted to approach a guarantor for payment unless they had taken reasonable steps to establish the reason for the borrower's non-payment, or until a specified period had elapsed.

2.5 In response to this feedback, we announced our intention to undertake further work to understand better how the guarantor lending market operates, and the risks to consumers, and how best these might be addressed – whether through targeted rules and/or supervisory action. If we decide that additional or different rules are needed, we indicated that we would consult on them.

¹ CP15/6 *Consumer credit – proposed changes to our rules and guidance* - February 2015.

² PS15/23 *Consumer credit – feedback on CP15/6 and final rules and guidance* - September 2015.

- 2.6 Annex 2 to PS15/23 provided further details of the feedback and our responses. On page 43 in response to the suggestion that firms should not be allowed to take money from a guarantor without prior warning or a default notice, we stated:

We may consider as part of our future work whether to require pre-notification to the guarantor before taking payment. We do not consider that taking or demanding payment from a guarantor would amount to 'enforcement' of the security (see CONC 13.1.6G) and so it would not require a CCA default notice.

- 2.7 Having considered this further, and in light of additional representations received, we now consider that this second sentence was incorrect.

The CCA requirements

- 2.8 Section 189 of the CCA defines 'security' as including a guarantee or indemnity, and 'surety' means the person by whom security is provided or to whom that person's rights and duties in relation to the security have passed.
- 2.9 Under section 105, any security provided in relation to a regulated credit agreement (or a regulated consumer hire agreement) must be expressed in writing. In the case of guarantees and indemnities, the form and content of the document (security instrument) must be in accordance with regulations³ made under section 105 and must be signed by or on behalf of the surety.
- 2.10 The regulations require specified information in the security instrument together with a prescribed statement of the surety's rights, including the following:
- The Consumer Credit Act 1974 covers this [guarantee/indemnity/guarantee and indemnity] and lays down certain requirements for your protection. If they are not carried out, the [creditor/owner] cannot enforce the [guarantee/indemnity/guarantee and indemnity] against you without a court order...*
- [...]*
- Under this [guarantee/indemnity/guarantee and indemnity] YOU MAY HAVE TO PAY INSTEAD of the [debtor/hirer] and fulfil any other obligations under the [guarantee/ indemnity/guarantee and indemnity]... However, if the [debtor/hirer] fails to keep to his side of the agreement, the [creditor/owner] must send him a default notice (and a copy to you) giving him a chance to put things right before any claim is made on you....*
- 2.11 Section 87 deals with default notices, and provides that a notice must be served on the debtor/hirer before the creditor/owner can take certain specified actions following a breach of the agreement by the debtor/hirer. Section 87(1)(e) specifies that this includes where it is proposed 'to enforce any security'.
- 2.12 The notice must be in accordance with section 88 and relevant regulations⁴, and must allow a period of at least 14 days after the date on which the notice is served. It must contain specified information, including the action the creditor/owner intends to take, the action required by the debtor/hirer and the consequences of failure to comply.

³ The Consumer Credit (Guarantees and Indemnities) Regulations 1983, SI 1983/1556.

⁴ The Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983, SI 1983/1561.

2.13 In addition, under section 111 the creditor/owner must serve a copy of the default notice on any surety. If this is not done, the security is enforceable against the surety (in respect of the breach to which the notice relates) on an order of the court only.

The FCA's view

2.14 Questions of interpretation of legislation are ultimately for a court to determine, and the FCA can only express a view. After reconsidering the matter we have now revised our view of how a court would be likely to interpret the relevant CCA provisions.

2.15 In reaching this view, we have considered the following:

- The CCA provisions on security are intended to provide a surety (including a guarantor and an indemnifier) with appropriate protections.
- The definition of security in section 189 of the CCA includes both guarantees and indemnities, and the CCA treats both types of security in the same way.
- Section 111(2) expressly contemplates that security is capable of being enforced without a court order.
- In the case of a guarantee or indemnity, security is realised if the creditor/owner seeks and obtains payment from the surety.
- This therefore also constitutes enforcement of the security.
- This includes where the payment is taken pursuant to a CPA or direct debit mandate which the surety has previously provided.
- The *McGuffick* judgment⁵ was concerned with enforcement under section 77(4) and did not consider the meaning of enforcing security under section 87.
- Section 87 requires a default notice, and section 111 requires a copy to be sent to the surety, before steps can be taken to enforce security.
- The statutory statement prescribed by the section 105 regulations states: ‘... if the debtor fails to keep to his side of the agreement, the creditor must send him a default notice (and a copy to you) giving him a chance to put things right before any claim is made on you’.
- These regulations apply equally to guarantees and indemnities.

2.16 In our view it therefore follows that if the creditor wishes to request or take payment from the guarantor following non-payment by the debtor, the creditor must first serve a default notice on the debtor (and provide a copy to the guarantor) and allow at least 14 days for response. This applies to all regulated credit agreements (and regulated consumer hire agreements) involving a guarantee or indemnity.

⁵ *McGuffick v Royal Bank of Scotland* [2009] EWHC 2386 (Comm).

- 2.17 Similar principles would apply in other cases involving enforcement of security.
- 2.18 In our view, failure to serve a valid default notice means that the creditor cannot take payment from the guarantor. If payment is taken, contrary to section 87, the debtor or the guarantor may have a cause of action against the creditor. In addition, in such cases the FCA may consider taking regulatory or disciplinary action against the firm.
- 2.19 While this guidance is not binding on firms, we would take it into account in deciding whether a firm has followed the law and whether, therefore, any supervisory or enforcement action is warranted. In light of the statement made in PS15/23 we would not expect to take disciplinary action solely on the basis that a firm has taken a payment from a guarantor, without issuing a default notice to the borrower and a copy to the guarantor, in relation to such actions taken by firms during the period from 28 September 2015 to 19 February 2016.

3 Next steps

- 3.1 We are publishing this document on the FCA website, and taking steps to bring it to the attention of firms involved in guarantor lending (where such lending is subject to the CCA) and other interested stakeholders.
- 3.2 We would welcome any comments or observations by Friday 18 March 2016. Following that and taking into account any responses received, we will look to issue a final statement of our guidance on this matter.
- 3.3 Responses may be sent in writing to the following address:

Consumer Credit Policy
Strategy & Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Email: martin.goulden@fca.org.uk