

Consultation Paper

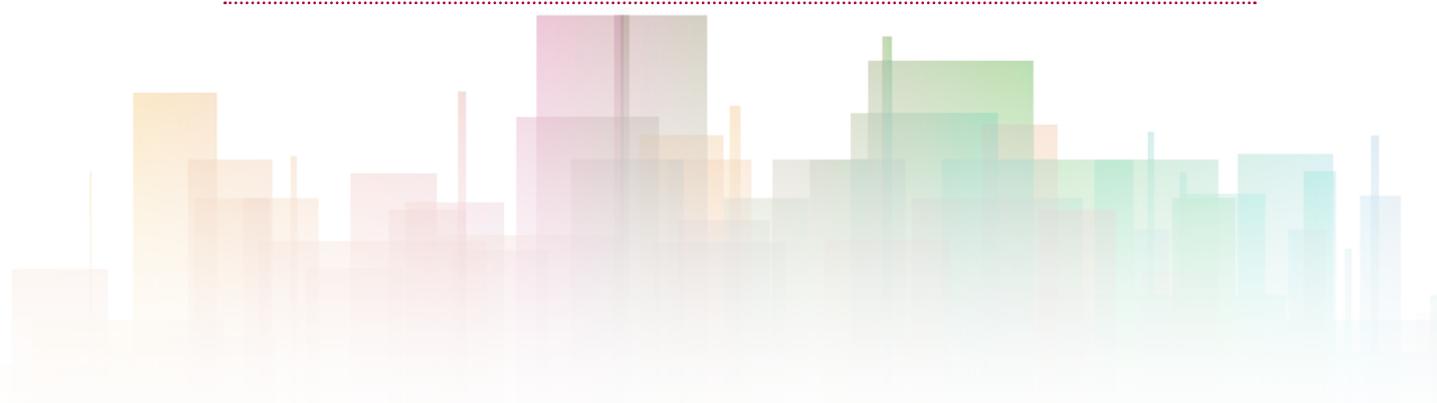
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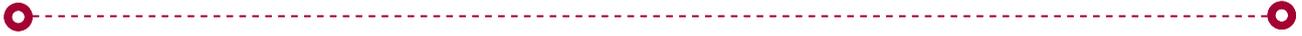
March
2013

High-level proposals for an FCA regime for consumer credit

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Abbreviations used in this paper

APF	Authorised Professional Firm
CASS	Client Assets module in the Handbook of Rules and Guidance
CBA	Cost Benefit Analysis
CCA	Consumer Credit Act
CCD	Consumer Credit Directive
DETINI	Department of Enterprise, Trade and Investment (Northern Ireland)
EEA	European Economic Area
EPF	Exempt Professional Firms
FCA	Financial Conduct Authority
FOS	Financial Ombudsman Service
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
FSF	Firm Systematic Framework
FSMA	Financial Services and Markets Act 2000
GEN	The General Provisions in the FSA Handbook of Rules and Guidance
IMLTs	Illegal Money Laundering Teams
OFT	Office of Fair Trading
PRA	Prudential Regulation Authority
PRIN	The Principles for Businesses module in the FSA Handbook of Rules and Guidance
SIF	Significant Influence Function
SYSC	The Senior Management Arrangements, Systems and Controls module in the FSA Handbook of Rules and Guidance
LATSS	Local Authority Trading Standards Services
VOP	Variation of Permission

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 1 May 2013.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2013/cp13-07-response.shtml.

Alternatively, please send comments in writing to:

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Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

1

Overview

- 1.1 On 6 March 2013 the Government published a consultation document setting out its proposals for transferring responsibility for consumer credit regulation from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA). The closing date for responses to their document is 1 May 2013. The transfer of consumer credit regulation from the OFT to the FCA will take place on 1 April 2014.

Why are we publishing a Consultation Paper?

- 1.2 This paper, which is being published by the Financial Services Authority (FSA) because the FCA will not exist until 1 April 2013¹, should be read together with the Government's consultation document. It describes how we propose that the FCA will carry out its new functions and use the powers that the Government plans to give it, taking account of its strategic and operational objectives, including to promote effective competition in the interests of consumers.
- 1.3 We are consulting at this stage on the framework for the new regime. There will be a further consultation later in the year on its detailed design, taking account of responses to this paper. We are proposing changes that we think will benefit consumers, but we appreciate there are significant differences between the existing Consumer Credit Act (CCA) regime and the new one. As the start of the transfer process comes closer, and as it proceeds, we intend to provide a lot of support to the firms affected, including targeted communications, presentations and plain language guidance.
- 1.4 Our proposals are summarised in Chapter 2 of this paper and the following chapters describe the process firms operating in the consumer credit market will go through as they transfer to FCA regulation.² Our analysis of the current failures in the consumer credit market and the costs and benefits of what we are proposing are in Annexes 2 and 3.
- 1.5 We are grateful to the OFT's Credit Group for sharing with us their experience and knowledge of regulating this market, which has helped us develop our proposals.

1 This paper is also being published on behalf of the PRA, who will make some rules for firms that are dual-regulated by the FCA and PRA.

2 Unless otherwise stated, references in this paper to consumer credit, credit and lending include second charge loans. Our proposals for second charge loans are summarised in Annex 7.

Who should read this Consultation Paper?

1.6 This paper will interest:

- firms that currently hold individual or group consumer credit licences issued by the OFT under the CCA;
- firms that are considering starting to carry on consumer credit activities;
- operators of peer-to-peer platforms (who will be affected by the Government's proposal to extend the perimeter);
- trade bodies representing consumer credit firms;
- consumer bodies;
- not-for-profit bodies providing debt advice;
- other bodies currently involved in regulating consumer credit, including the Local Authority Trading Standards Services (LATSS) and the Department of Enterprise, Trade and Investment (Northern Ireland) (DETINI); and
- groups that represent those with protected characteristics (age, gender, disability, race, pregnancy and maternity, religion and belief, sexual orientation and transgender) as they may wish to comment on our equality impact assessment (Annex 4).

Next steps

1.7 At this stage in developing the new regime, we are mainly interested in your views on the key features of the proposed model. We have included some questions at the end of each chapter and these are listed in Annex 1. Some relate to technical issues but we need your views to help us develop our proposals in more detail.

1.8 Please send us your comments by 1 May 2013. We will review all your responses and publish our feedback, including the final text of the high-level standards and interim permission fees rules on which we are now consulting (see Chapters 7 and 13 and Appendix 1). More information on our other expected consultations relating to this new regime are in Chapter 14 (Next steps).

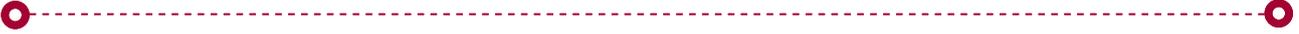
Table 1.1 – Our key milestones

Closing date for this consultation	1 May 2013
FCA feedback on this consultation	Summer/autumn 2013
Second FCA Consultation Paper: detailed rules for the new regime	Autumn/winter 2013
FCA starts to consider notifications from CCA licensed firms for interim permissions to take effect from 1 April 2014	Autumn/winter 2013
Policy Statement in response to the second consultation	March 2014
Transfer to FCA regulation takes effect	1 April 2014
FCA starts to consider applications for authorisation from firms with interim permissions	Autumn/winter 2014
Authorisation process completed	Spring/summer 2016

Issues for consumers

The majority of adults in the UK are consumers, or potential consumers, of the financial services covered by the proposals in this paper. You may have taken out loans, used a credit card, had difficulties paying back debt, or looked for advice on debt problems. So you may be interested in commenting on how we propose to regulate consumer credit firms. We have included a box at the start of most chapters describing what we think are the main benefits of our proposals.

For example, you may wish to comment on our proposal broadly to carry across the existing protections for consumers, and tell us if there are any gaps in protection that should be filled. Are we right in thinking that the broking of consumer credit by retailers and car dealers on their own premises poses lower risks to consumers than the selling of credit by financial services firms? And what are your views on the redress available to consumers if things go wrong?



2

The proposed framework for the new regime

Our regime proposals aim to deliver the Government's objectives for the transfer. These are to:

- increase protection for consumers; and
- have a proportionate regime that only places requirements on firms if there is a clear benefit for consumers.

The benefits of this will be a stronger, more flexible regime, better resourced to deal with problems. It will be tailored to the risks of the consumer credit markets, minimising burdens on industry where risks are lower.

Legal structure

- 2.1 The Government intends the Financial Services and Markets Act (FSMA)¹ will replace the provisions of the CCA that cover licensing and other aspects of the regulatory framework for consumer credit regulation.
- 2.2 The powers to authorise, supervise and enforce against firms carrying on consumer credit activity will come from FSMA. It gives us the power to make rules and requires us to consult on, and publish a cost benefit analysis of our proposed rules.
- 2.3 Many provisions of the CCA will remain in place and will continue to form an important part of the required standards for lending; for example, the form and content of credit agreements will remain in CCA secondary legislation. Our rules and guidance will also form key parts of the new consumer credit regime.²
- 2.4 There will be new 'high-level' rules and guidance, which set out general standards of behaviour and requirements about the controls firms must have in place. We propose that the conduct provisions which are removed from the CCA will be replicated as FCA rules, and the OFT's guidance will be replicated as FCA rules and guidance where appropriate.

¹ References to FSMA in this paper are to the Act as modified by the Financial Services Act 2012.

² Annex 8 gives an overview of the proposed future legal structure.

We also want your views about whether there are provisions in voluntary industry codes that we should make into FCA rules or guidance.

- 2.5 No new firms will be brought within the scope of the Prudential Regulation Authority (PRA) as a result of the transfer of consumer credit. The PRA will make some rules for firms that are dual-regulated by the FCA and PRA, for example, a rule on status disclosure for PRA authorised firms which carry on credit activities. Some technical amendments may need to be made to the rules to align the drafting with the PRA's approach to rule-making.

Meeting the Government's objectives – our approach to developing a new regime

The FCA's approach

- 2.6 We published *'Journey to the FCA'* in October 2012, which set out our vision to create an organisation that makes relevant markets work well so consumers get a fair deal.³
- 2.7 In it we identified three broad outcomes that we want to achieve. These are that:
- consumers get financial services and products that meet their needs, from firms they can trust;
 - markets and financial systems are sound, stable and resilient, with transparent pricing information; and
 - firms compete effectively, with the interests of their customers and the integrity of the market at the heart of how they run their businesses.
- 2.8 This underpins our approach to the design of the consumer credit regime and our proposals share many of the features of our approach to other regulated markets. Where there are differences, this reflects the need to deliver a regime that is proportionate for the different segments of this market and appropriate to the risks.

Strengthening consumer protections

- 2.9 The Government has stated that it wants the FCA regime to deliver improved consumer protection. The National Audit Office has also identified improvements that could be made to reduce consumer harm in the credit market.⁴ We have taken account of their recommendations in our regime design.

³ http://www.fsa.gov.uk/about/what/reg_reform/fca

⁴ Regulating Consumer Credit, National Audit Office, 19 December 2012.

Table 2.1: Risks throughout the product lifecycle for consumers using consumer credit

Stage in lifecycle	Potential problems for consumers
Product/service design	Product/service design inherently flawed.
Advertising/sales	Misleading/unclear advertising. Inappropriate targeting. Undue pressure.
Lending decision	For example, inadequate assessment of affordability.
Customer falls into arrears	For example, complex/unclear charges, arrears and penalties. Exploitative arrears charging and lack of forbearance.
Options reduced for credit-impaired consumers	For example, exploitative cost increases. Credit-impaired consumers misled into paying upfront brokerage fee in belief it will secure a loan.
Consumer seeks help with debts	For example, misleading advertising of debt advice/debt management solutions. Poor quality debt advice. Lack of transparency about potential risks of debt management solutions.
Consumers with no access to legal credit	Very serious consequences for consumers who deal with illegal 'loan sharks'.

2.10 While we see significant scope for serious consumer harm at every stage of the product lifecycle, we need to develop our understanding of which risks are most acute for consumers and where these are most likely to happen. Our regime enables us to target our resources at the key risks, so as we build our experience of regulating the industry we will be able to take action where it makes a real difference for consumers.

2.11 The framework gives us the tools to deliver better outcomes for consumers than the existing regime is able to deliver:

- **Increased flexibility** – rule-making powers, including the power to ban products, will enable us to give a prompt and tailored response to product and service innovations that are harmful to consumers.
- **More resource** than the OFT, enabling us to act on a wider range of issues.

- **Dealing with problems earlier** – we will have: more access to information about firms through their reporting; scope to take a market-wide approach by requiring action from all firms in a sector; and more proactive supervision of higher-risk firms.
- **Better standards in the industry** – more scrutiny of higher-risk firms before they are allowed to operate in the market and significantly more scrutiny of the integrity and competence of individuals in key positions in all firms. The legal status of certain FCA rules (rather than OFT guidance) will encourage firms to comply with wider enforcement powers also acting as a deterrent for non-compliance.
- **Improved access to redress** – we will have the power to require firms to reimburse consumers when they have lost out due to a firm's actions.

Price-capping and restrictions on the duration of loans

- 2.12 Based on the University of Bristol research for the Department for Business, Innovation and Skills (BIS)⁵, the Government has concluded that at present a variable total cost of credit cap is not the way to address consumer detriment in the payday lending market in the short term. However, they do not want to close it off as a potential solution in the future and so the Government has given us a specific power to cap the overall costs of loans and restrict how long they can last for and the amount of times they can be rolled over.
- 2.13 We think there is further work that should be done to decide whether or not to use the power in future, such as the impacts of different levels of cap and the outcomes for consumers unable to access credit due to a cap. We will engage with stakeholders on this issue in the near future and, when responsibility for consumer credit transfers to us in April 2014, we will start the analysis to help us decide whether or not to use the new power.

Payday lending

- 2.14 The OFT has published its findings of the review of payday lenders' compliance with their Irresponsible Lending guidance, which has highlighted a number of serious problems in this sector.⁶ The University of Bristol's research referred to above also identified issues. We will take a robust approach to tackling problems in this sector and will look at identifying any gaps in the rules that need to be filled. If necessary, this may mean new rules that take effect at or around the time of transfer.
- 2.15 We will examine the relevant industry codes, and consider whether the additional protections in them should be made into rules. Where we identify areas that provide clear protections to consumers we will consult on bringing these into force as soon as possible. This could result in new rules in place at April 2014.
- 2.16 We are engaging with consumer groups, debt charities and trade associations to gain more knowledge of the sector and will continue to engage with them and with the OFT to explore where any gaps may exist in the current regulatory framework.

⁵ The Impact on Business and Consumers of a Cap on the Total Cost of Credit, University of Bristol Personal Finance Research Centre, March 2013.

⁶ Payday Lending: Final Report, Office of Fair Trading, March 2013

- 2.17 We will also focus on the content of any advertising where we see potential material risks for consumers and will take robust action where we find breaches of our rules on financial promotions.

Making the regime proportionate

- 2.18 A key objective for the new regime is ‘proportionality’, which means ensuring that additional costs and burdens are only placed on consumer credit firms where they are needed to provide consumer protection. Our proposals take into account both the risks to consumers and the importance of consumer credit to consumers in managing their finances. We propose to intervene where there is a strong case that it will directly benefit consumers. The cost benefit analysis published with this paper shows our estimates of the costs to firms and benefits to consumers and firms of our proposals.

- 2.19 The following are the key features of the proportionate approach:

- **Reduced requirements** for firms carrying out certain lower-risk activities.
- **A transitional period** to help existing OFT licence holders to prepare for aspects of the new regime. Further details are set out below.
- **Limited reporting requirements:** we will require firms to report key information, but our emphasis will be on assessing the market-wide risks (rather than individual firm risks) and using other information sources, including intelligence from consumer groups. Further details are in Chapter 9.
- **Limited capital requirements:** we do not propose to specify minimum levels of capital that firms must hold. The exception to this is debt management firms – we propose a minimum capital requirement for these firms. Further details are in Chapter 6.
- **No compensation scheme cover:** there are no proposals for Financial Services Compensation Scheme (FSCS) cover for consumer credit activities as there are limited risks to consumers’ money in these markets. The exception is the risks from debt management activities. Rather than apply the FSCS, we propose to tackle the risks to consumers’ assets posed by debt management companies through stricter client asset rules for the largest firms and a minimum capital requirement.
- **Tailored requirements for pre-approval of individuals in firms:** firms will need pre-approval for key employees in particular roles, including those who exert a significant influence over a firm’s business. Employees in consumer-facing roles will not need pre-approval.

A different approach for lower-risk and higher-risk activities

- 2.20 We propose to differentiate our approach according to two broad groups of activities – referred to as ‘lower-risk’ and ‘higher-risk’ (see Tables 2.2 and 2.3 for the activities in these groups), with further differentiation within these groups based on firm and sector specific risks.

Table 2.2 – Lower-risk activities

- **Consumer credit lending**

Lending activities where their main business is selling goods and non-financial services and there is no interest or charges (and no hire purchase or conditional sale agreement). For example, a sports club that allows payment by instalment for membership, without any additional charge.

- **Consumer hire**

Hiring goods to consumers, such as tool and car hire.

- **Secondary credit broking**

Broking where the firm's main business is selling goods and non-financial services and broking is a secondary activity. For example, a car dealership that introduces customers to lenders. The lower-risk activity does not include broking carried on in the consumer's home on more than an occasional basis.

- **Not-for-profit debt counselling and debt adjusting**

Including advising people on discharging specific debts and helping people with their debt problems by taking over their debts or negotiating on their behalf, where carried out by a not-for-profit body.

- **Not-for-profit credit information services.**

Obtaining information about someone's credit record or helping them change their credit record, where carried out by a not-for-profit body.

Table 2.3 – Higher-risk activities

- **Consumer credit lending**

Including personal loans, credit card lending, overdrafts, pawnbroking, hire purchase, conditional sales etc. But excluding lending by sellers of goods and non-financial services where there is no interest or charges.

- **Credit broking**

Including introducing consumers to lenders. But excluding broking by sellers of goods and non-financial services as a secondary activity (unless the broking is carried on in a consumer's home on more than an occasional basis e.g. double-glazing sellers selling credit to the consumer in their home).

- **Debt adjusting**

Helping people with their debt problems by taking over their debts or negotiating on their behalf. But excluding not for-profit debt adjusting.

- **Debt counselling**

Including advising people on discharging specific debts. But excluding where carried out by a not-for-profit body.

- **Debt collection**

Collecting debts due to others under credit or hire agreements.

- **Debt administration**

Carrying out activities relating to consumer credit agreements on behalf of a lender.

- **Credit information services**

Obtaining information about someone's credit record or helping them change their credit record. But excluding not-for-profit credit information services.

- **Credit reference agency**

Collecting information about consumers' financial standing to inform the decisions of consumer credit firms.

- **Operating an electronic system in relation to lending**

The new regulated activity proposed by the Government concerning peer-to-peer platforms.

Lower-risk activities

2.21 We have classified these activities as lower-risk because we think the risks to consumers are limited in some way:

- **Consumer credit lending:** where there are no interest or charges, the risks to consumers are reduced.
- **Consumer hire:** we see minimal risks to the consumer, given the provisions that will remain in the CCA that protect consumers from getting tied into long-term contracts.
- **Credit broking as a secondary activity:** the OFT has not seen significant consumer harm arising from credit broking in these markets. However, it has taken action against firms whose business models are premised on pressure-selling to vulnerable consumers, in their homes⁷, and so firms broking in the home are classified as higher-risk.

2.22 Firms carrying out lower-risk activities will be subject to more limited scrutiny for becoming an authorised firm than higher-risk firms. They are referred to in this paper as having a ‘limited permission’. This reflects the limited scope of activities which firms in this category are permitted to carry out and the more limited nature of the authorisation process and supervisory regime.⁸ We would welcome any suggestions for a different term which might have a clearer meaning for consumers.

2.23 Firms with limited permission will:

- be subject to mainly reactive supervision, which will primarily respond to intelligence received about existing problems;
- report only basic information, for example, revenue or number of transactions; and
- have lower authorisation and annual fees.

2.24 We believe that this differentiation is appropriate to reflect the different risks of the activities in these groups; however, we do not view these firms as low risk. All credit activity carries risks for consumers – the risks from these firms are just lower than other consumer credit activities. We will still have our full regulatory powers to take action against these firms where we see them causing problems for consumers.

Table 2.4 at the end of this chapter illustrates the features of the lower- and higher-risk regimes.

The option to become an appointed representative

2.25 As a potentially lower cost alternative to authorisation or authorisation with a limited permission, firms that are not lenders or credit reference agencies may instead make arrangements with an authorised firm to become their ‘appointed representative’. Details about this option are included in Chapter 5. In brief, the authorised firm (the principal) must take responsibility for the appointed representative’s regulated consumer credit activities.

⁷ For example, the OFT revoked the licence of a firm found to be pressure-selling high-cost security and fire alarm systems to consumers in their homes: <http://www.ofc.gov.uk/news-and-updates/press/2011/84-11>

⁸ Persons who carry on the lending, broking and hiring limited permission activities can also apply to carry on, as an ancillary activity, debt counselling, debt adjusting and credit information services.

Smoothing the transition

- 2.26 The timetable for the transfer is challenging. A transitional period from April 2014 is, therefore, an important feature of our proportionate approach and gives us time to prepare for the full regime.
- Firms with a valid OFT licence on 31 March 2014 will be able to continue carrying on the consumer credit activities for which they are licensed for a period after 1 April 2014, as long as they notify us of some basic information and pay a fee. They will be treated as having an ‘interim permission’ or, if they are already authorised by the FCA or PRA, as having an ‘interim variation of permission’.
 - Firms new to the credit industry from 1 April 2014 onwards will need to apply for full authorisation.
 - Firms will not have to apply for approval for certain individuals in their firms until the firm applies for full authorisation or, if they are already authorised by the FCA or PRA, a variation of permission.
 - Reporting requirements will not start until a firm is fully authorised.
 - Minimum capital requirements for debt-management firms will not start until a firm is fully authorised.
 - Conduct rules and guidance will be in place from 1 April 2014 and will apply to all firms whether with a limited permission or fully authorised.
- 2.27 Chapter 7 on conduct standards proposes that where CCA provisions are repealed their substance will be replicated in new FCA rules and guidance. OFT guidance will be similarly replicated in rules or guidance. To give firms time to get used to these ‘transposed’ rules and guidance, we propose a six-month period, during which, if firms can demonstrate that they are acting in accordance with a corresponding rule or guidance from the previous regime which is the same in substance as ours, we will not take action against them.

The impact on competition

- 2.28 We have taken account of our objective to promote effective competition in the interests of consumers and of our duty to advance that objective⁹, adopting the following principles in our regime design:
- Ensure competition in the market does not reduce and there is no material impact on the supply of credit.
 - No firm is able to gain an unfair advantage at the expense of competitors due to the regulations of the new regime.
 - The amount of available credit and access to this is not materially reduced for consumers through unnecessary regulatory burdens on firms.

⁹ The duty to promote “effective competition in the interest of consumers” in so far as that is compatible with acting in a way which advances the FCA’s consumer protection objective or integrity objective.

- Transfer of existing licensees into the regime is cost-effective, efficient and not overly burdensome.

2.29 We have assessed the impact on competition of our proposals as a package and the wider impacts of the proposed new regime are expected to be very limited. We expect:

- little impact on competition in consumer credit markets;
- minimal impacts on volumes of lending and on the cost of credit; and
- minimal impacts on innovation or access to credit.

2.30 This is discussed further in our CBA in Annex 3.

An evolving regime

2.31 Once the regulation of consumer credit has transferred to the FCA, and as we build our expertise and experience in regulating consumer credit, we will keep the regime design under review and develop it where we see new risks and better ways of protecting consumers and promoting effective competition.

2.32 In particular, the Government has proposed a requirement that, by April 2019, we provide them with a report on whether the repeal of the remaining provisions of the CCA would adversely affect consumer protection. We will consider whether the burdens placed on firms by the CCA provisions are proportionate to the benefits and whether we are able to make alternative rules in order to continue protections for consumers. We will engage with stakeholders during the course of our review.

2.33 In general, we do not expect to change our overall approach in the medium term, but retaining the flexibility to deal with particular problems is a key benefit of the FCA regime. A post-implementation review will, in due course, provide the basis for reassessing the overall approach.

Local Authority Trading Standards Services

2.34 The Government has proposed that LATSS and DETINI will continue to have a role in enforcing the remaining provisions of the CCA and have power to prosecute specified offences in FSMA that relate to credit activities (although only one authority will be able to bring enforcement action against a firm for a particular offence).

2.35 LATSS and DETINI will also continue to combat illegal money lending and have the powers to bring criminal actions to do so. As organisations with enforcement powers, we will work together with the LATSS and DETINI to ensure a coordinated approach to our joint responsibilities. We also value the role of LATSS and DETINI in ‘front-line’ intelligence-gathering and will work with them to make the most of opportunities to share intelligence. We describe this further in Chapter 10.

Summary of our proposals

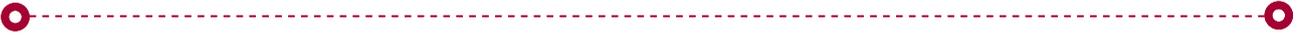
We propose a proportionate regime, designed to target key risks within a strengthened framework that delivers increased consumer protection. There will be:

- stricter conditions of entry, increased scrutiny of individuals and proactive supervision of higher-risk firms;
- wider enforcement powers, with improved access to redress for consumers;
- reduced requirements for firms carrying out certain lower-risk activities;
- a transitional period to help smooth the transfer for firms;
- limited reporting and capital requirements; and
- no FSCS cover for consumers.

Q1: Do you agree that our proposals strike the right balance between proportionality and strengthening consumer protection?

Q2: Do you agree that we have included the right activities in the higher- and lower-risk regimes?

Q3: Do you agree that our proposals minimise any adverse impact on competition within the regulated consumer credit market?



3

Transition: the interim permission regime

Our proposals for an interim permission regime will see improved standards in the consumer credit market because firms must comply with FCA rules. If they do not comply, the FCA can use its wide-ranging enforcement powers to take action against them.

Introduction

- 3.1** The Government proposes that firms with OFT consumer credit licences will be able to continue carrying on the regulated consumer credit activities that they are licensed for from 1 April 2014 by notifying the FCA within the specified time period that they want to have ‘interim permission’ and paying any required fee¹.

Outline of the proposals

- 3.2** When consumer credit moves from the OFT to the FCA in April 2014, we want to make sure the transition for firms is as straightforward as possible. To make sure OFT-licensed firms that want to continue carrying on their credit activities are able to from 1 April 2014 onwards, the Government proposes that they will need to notify us before then that they want an interim permission. The detail of the interim procedure is set out in the Government’s draft Regulated Activities Order², which sets the legal basis for the interim permission regime.
- 3.3** We expect firms to be able to make such a notification well in advance of 1 April 2014. Existing OFT licences will lapse on 31 March 2014 and interim permissions will begin

¹ Firms that fail to notify will not be entitled to an interim permission and will not be able to carry on a credit regulated activity on and after 1 April 2014. Firms that have had their licence revoked will not be eligible for interim permission.

² In the draft Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013, a consultation draft of which is published in the Government’s recent consultation.

from 1 April 2014³. If a firm does not have an interim permission it will not be able to continue to carry on a regulated consumer credit activity after 1 April 2014 unless it is an exempt person or Part 20 FSMA applies (see Chapter 4 for details on this). If a firm carries on regulated activities without permission it will be at risk of enforcement action. We propose to charge a one-off fee for granting interim permission, which will cover the time the interim permission is held. Chapter 13 sets out more information on fees.

Firms not already regulated by the FCA or the PRA

- 3.4 The Government proposes that, where a firm is not already regulated by the FCA or the PRA, but has an existing OFT consumer credit licence, it should be able to notify the FCA, pay the required fee, and so long as the licence is not suspended on 31 March 2014, obtain an interim permission for the consumer credit activities covered by its licence.⁴

Firms already regulated by the FCA or PRA

- 3.5 The Government proposes that, where a firm is already regulated by the FCA or the PRA for non-consumer credit activities and has an existing OFT consumer credit licence, it will be able to notify the FCA, pay the required fee and, so long as its licence is not suspended on 31 March 2014, obtain an ‘interim variation of permission’ to continue to carry on its licensed consumer credit activities alongside its other regulated activities.
- 3.6 The Government proposes that a firm that is an appointed representative of one or more firms regulated by the FCA or the PRA on 1 April 2014 for an existing FSMA-regulated activity should be able to hold an interim permission to carry on consumer credit activities, as well as continuing to be an appointed representative.

Peer-to-peer lending=

- 3.7 Peer-to-peer platforms are online marketplaces that match up potential lenders with potential borrowers and facilitate the contracts between the two parties. Most peer-to-peer platforms are already regulated by the OFT for their ‘debt administration’ activity. The Government proposes that the extent to which the activities of peer-to-peer platforms will be regulated should change and that a new bespoke regulated activity, operating an electronic system in relation to lending, should be created to cover peer-to-peer platforms facilitating lending and borrowing between consumers or between consumers and businesses. The Government proposes that firms that hold a licence with the category of debt administration and want to carry on the new regulated activity will be eligible for an interim permission.

Third party tracing agents

- 3.8 Tracing a borrower who owes debts under consumer credit agreements on behalf of a third party is currently an activity for which a consumer credit licence (with the category of ‘debt collection’) is required. However, the Government is proposing that a third party tracing

3 We expect that any Directions issued by the OFT to licensees waiving or varying CCA requirements will be carried forward into the interim permission regime in April 2014.

4 Special rules apply to carrying on credit broking and credit intermediation and to the new peer-to-peer platforms.

agent to whom a firm (most likely a lender or a debt collector) outsources the tracing activity, and takes no other steps to collect debts, will not need to be authorised by the FCA and, therefore, will not require an interim permission to carry on this activity.

- 3.9 The effect of our proposed systems and controls rules would be that, if an authorised firm outsources the tracing activity to a non-authorised third-party, the authorised firm remains fully responsible for the carrying on of the activity.

Not-for-profit debt advice bodies

OFT group licence holders

- 3.10 The Government proposes that not-for-profit bodies⁵ that have an OFT group consumer credit licence to provide debt counselling should be able to carry on those activities *without* having an interim permission. They would also be entitled to carry on debt adjusting and providing credit information services if they hold credit licences with the appropriate categories.⁶

OFT individual licence holders

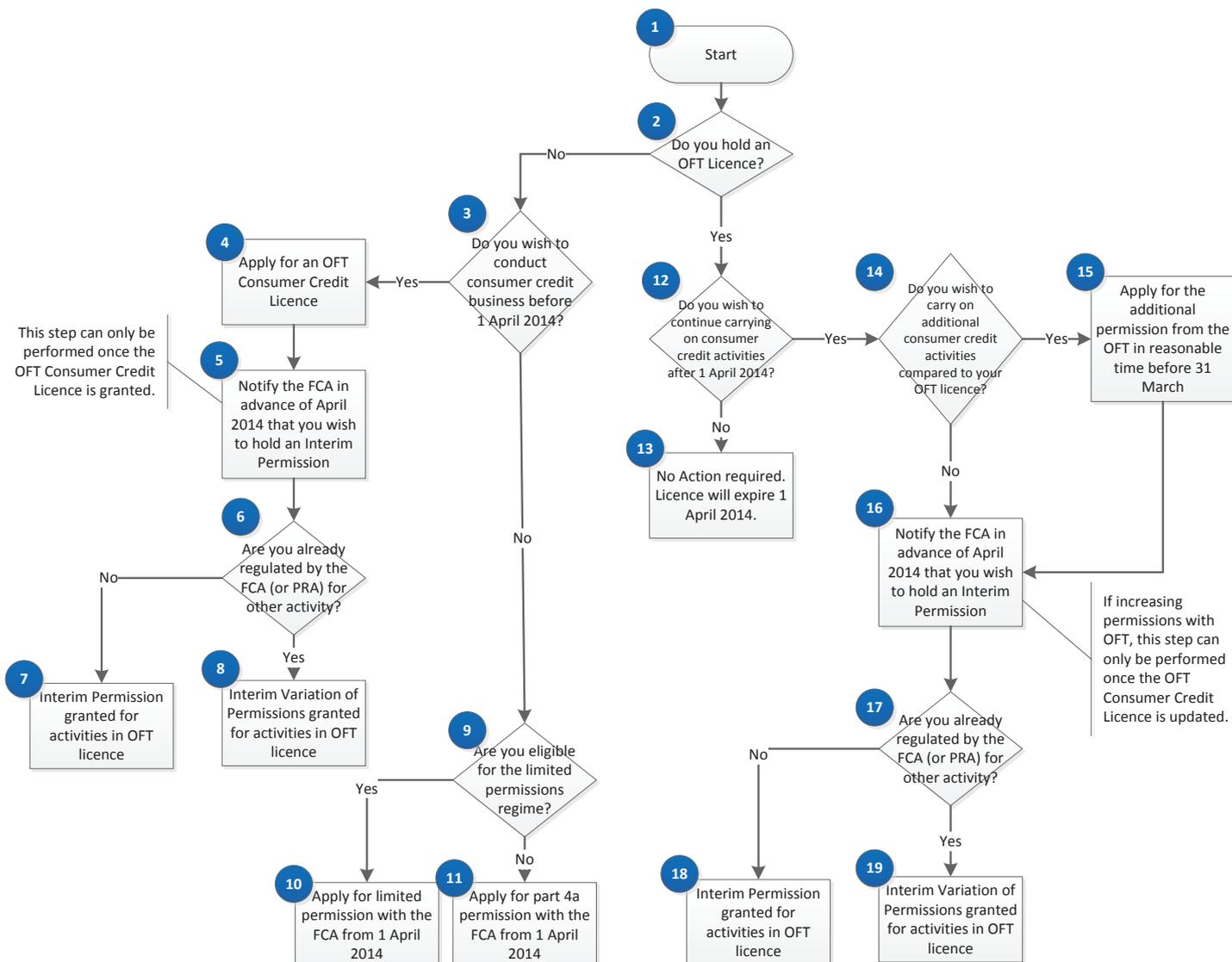
- 3.11 The Government proposes that not-for-profit bodies which hold individual consumer credit licences for debt counselling, debt adjusting or providing credit information services⁷, as opposed to those providing debt advice under a group licence, will, subject to the notification requirement described above, be entitled to an interim permission.⁸ We propose this should be without having to pay a fee for the interim permission.

5 As defined in the Government's draft secondary legislation.

6 Under the OFT consumer credit licensing system, firms that do not charge for the debt advice they provide and associated services hold 'non-commercial' categories on their credit licences. Under the FCA regime the definition is proposed to be 'not-for-profit bodies'.

7 In each case for non-commercial activities.

8 See also subsection on not-for-profit debt advisers in Chapter 4.

Table 3.1: Decision Tree for Interim Permissions Regime⁹

Notifying the FCA that you need an interim permission

3.12 We propose that firms should request a log-in from our website using their OFT licence number and email address. We will provide log-in details to allow the interim permission notification to take place through email. Firms will then access the following information from the OFT register and will need to validate or update this information;

- the firm's contact details and controllers; and
- a list of consumer credit activities that the firm is currently licensed to undertake. Firms will only be eligible to carry on activities for which they have a current and not suspended OFT licence on 31 March 2014.¹⁰

⁹ This decision tree does not include firms with OFT Group Licences.

¹⁰ More detail is available in Chapter 9 – Supervision and Reporting.

- 3.13** We propose to ask firms to provide, on a voluntary basis, some limited information to help supervise the firm. This could include turnover, transaction information and complaints information, number of branches, location of branches and number of agents and supervisors of agents.
- 3.14** We do not propose that firms will have to have key individuals pre-approved by us to hold an interim permission. Firms will also not need to notify the FCA about any changes to controllers and key individuals during the interim permission phase.

Keeping public records of interim permissions

- 3.15** The names, contact details and consumer credit permissions of firms that are able to carry on regulated activities will be accessible on the FCA and PRA websites.

How long is an interim permission valid?

- 3.16** The interim permission for consumer credit activities will be valid until:
- The firm applies to cancel its interim permission and this is approved by the FCA or the PRA;
 - The firm applies for authorisation or ‘variation of permission’ (see Chapter 4) and the FCA or PRA has either approved it or issued a Decision Notice to refuse it;
 - Where the application date specified by the FCA in a direction has passed – this is the latest date on which a firm must apply for authorisation (or a variation of permission) if it wants to continue to carry on the activities covered by its interim permission; or
 - 1 April 2016.¹¹

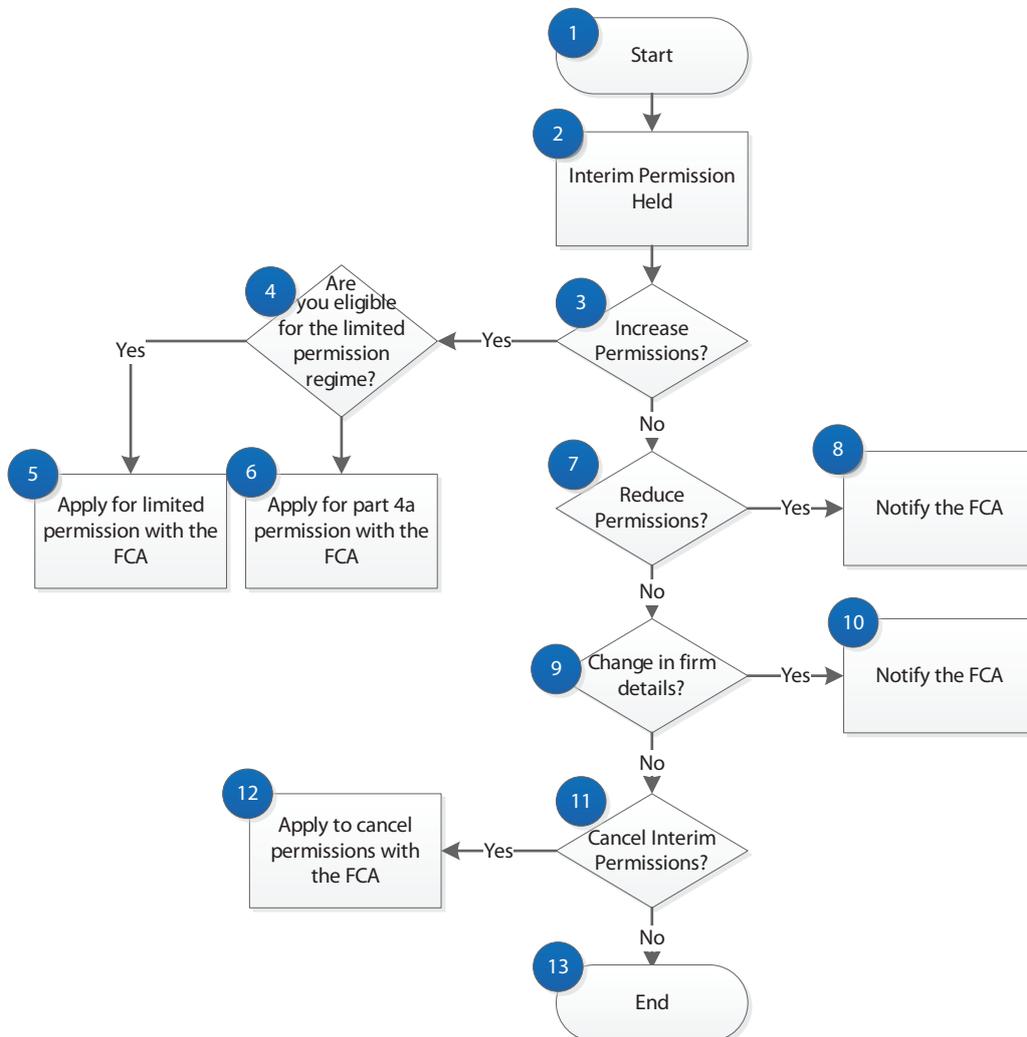
Changing your activities during the interim permission period

- 3.17** Where a firm has interim permission for numerous activities, and wants to stop carrying on an activity, we propose that it will not have to notify the FCA. If a firm wishes to remove activities from its permission, this will be through a simple notification. However, where it wants to stop carrying on all activities for which it has interim permission or interim variation of permission it will have to notify the FCA. Firms should also notify the FCA where the details we hold change. This will ensure that the register is up to date for consumers to use.

¹¹ Where a firm has an interim permission that covers both second charge lending and another form of consumer credit lending, and they gain full authorisation in respect of the latter, the proposed legislation allows the firm to retain the interim permission status for their second charge lending.

- 3.18 If a firm wants to carry on new regulated activities (whether or not they relate to consumer credit), we propose that the firm should apply for authorisation or variation of permission for both the new regulated activities and existing credit activities.
- 3.19 Firms with an interim permission will not be required to notify the FCA of any changes to controllers or key persons.
- 3.20 Table 3.1 sets out where firms with interim permission or interim variation of permission will have to notify us or seek approval during the interim permission regime.

Table 3.2 Decision Tree for changes during the Interim Permissions Regime



Interim permission and appointed representatives

- 3.21 As a potentially lower cost alternative to authorisation, some firms may instead make arrangements with an authorised firm to become their ‘appointed representative’. The Government proposes that firms with an interim permission or interim variation of

permission should not be able to have appointed representatives for credit activities. This is because firms with interim permission will not have been assessed by the FCA on their ability or resources to take responsibility for the credit activities of other firms.

How will we supervise firms during the interim permission regime?

- 3.22** To ensure we use our resources in the most effective way, we propose that during the interim permission regime we supervise consumer credit firms almost entirely through ‘event-driven’ and ‘issues-based’ supervision. See Chapter 9 for more details.
- 3.23** We propose that once firms have been granted interim permission or interim variation of permission they should not have to provide the FCA with regulatory information; however, we will establish relationships with key external stakeholders and use other sources of intelligence to help us supervise firms. We will respond to events arising in firms as appropriate.
- 3.24** We also propose to carry out work across the consumer credit market during the interim permissions regime so we can have a better understanding of the potential risks and their impact on the consumer credit market. If we find something wrong we will expect it to be put right and use investigative powers if necessary. We also propose to conduct ‘firm familiarisation work’ with the most significant firms to get a clear understanding of their business models and the impact they have on the consumer credit market.¹²
- 3.25** We believe that this approach will help us to move into a full supervision regime with a proper understanding of the market. We can then begin fully supervising and engaging with firms in an effective yet proportionate way.

What will happen if a firm fails to apply for an interim permission?

- 3.26** If an OFT licensee fails to notify the FCA that it wishes to have an interim permission, or it fails to pay the required fee, it will have to stop carrying on its consumer credit activities. If a firm carries on regulated credit activities without permission from 1 April 2014 it will be committing an offence and it will be at risk of enforcement action. We will also be able to take enforcement action with a view to applying sanctions against firms that have an interim permission if they have not met the applicable requirements, including those of the CCA and, from 1 April 2014, the rules made by the FCA or PRA. See Chapter 10 for more information on enforcement.

¹² A description of the supervision activities is provided in Chapter 9 – ‘Supervision and Reporting’

Summary of our proposals

- OFT consumer credit licensees can continue carrying on the regulated activities that they are licensed for from 1 April 2014 by notifying us that they want to have 'interim permission' and paying the required fee.
- We propose to begin accepting applications for interim permission or interim variation of permission well in advance of March 2014.
- Firms that are already authorised by us or the PRA and hold a CCA licence, will be eligible for an interim variation of permission.
- If a firm with an interim permission wants to carry on additional regulated activities, it must be authorised by, or have a variation of permission from us or PRA for the consumer credit activity covered by its interim permission and the additional activity.
- We will supervise firms entirely through 'event-driven' and 'issues-based' work.
- During the interim permission regime we will also conduct work with significant firms and take action where we identify misconduct.
- Where an OFT licensee fails to notify us in time that it intends to carry on regulated consumer credit activities, it must stop carrying on those activities on 1 April 2014. If it continues to carry on regulated activities it will be committing an offence and it will be at risk of enforcement action.

Q4: Do you have any comments regarding our proposals for the interim permission regime?

4

Authorisation

Introduction

- 4.1** The Government proposes that interim permissions will expire by 1 April 2016 at the latest (see Chapter 3 for more details). However, in the case of firms which apply for a full authorisation or variation of permission by the application date specified in the direction made by the FCA, the interim permission ceases when we or the PRA (as appropriate) determine the application, which could potentially be after 1 April 2016.
- 4.2** Before 1 April 2016, all firms with an interim permission that want to carry on regulated consumer credit activities should have applied for full authorisation or variation of permission to us, or PRA if they are dual regulated. To become authorised, firms must demonstrate that they meet the Threshold Conditions as set out in FSMA.
- 4.3** This chapter sets out the proposals for the authorisation process for consumer credit firms, including:
- full and limited permission standards;
 - authorisation requirements for overseas firms;
 - dates and timings for applications;
 - the appeal procedure; and
 - our approach to approving individuals responsible for certain functions.

Authorisation standards

- 4.4** Firms must demonstrate at the time of authorisation that they will satisfy, and continue to satisfy, the minimum standards set out in FSMA, called the Threshold Conditions (TCs)¹, for all the regulated activities that they want to carry on. The firm must also show that the

¹ See Schedule 6 to FSMA, but also note that the Threshold Conditions are proposed to be modified in certain cases by the Government secondary legislation.

persons running the firm are ‘fit and proper’ to perform that function². Table 4.1 sets out the TCs that are likely to be in place in April 2014 and our proposals on how we will assess applications against these standards.

- 4.5 When we assess a firm’s application, the size of a firm will play a part in how intrusive we are. However, making sure our approach is proportionate is more to do with assessing the risks of a particular business model to consumers. The Government proposes to modify the Threshold Conditions for certain lower-risk regulated activities (see paragraph 4.7).

Table 4.1 – Threshold Conditions

Threshold Condition	Explanation	Proposed approach for higher-risk firms	Proposed approach for lower-risk firms applying for a limited permission
Legal status (dual-regulated firms only)	Firms must have a certain legal status to carry out certain regulated activities.	Check the firm is registered with Companies House with the appropriate legal status and review appropriateness of firm name.	Not applicable (see paragraph 4.7).
Location of offices	If the firm is a body corporate constituted under UK law, the firm’s ‘mind and management’, e.g. directors, compliance function, audit function, should be in the UK.	Validate the main place of business and check that the mind and management of the firm is in the UK.	Validate main place of business and check that the mind and management of the firm is in the UK.
Effective supervision	A firm must be capable of being effectively supervised by the FCA, including the complexity of its regulated activities, products, and how the business is organised. In most cases, firms should have a UK establishment. This will be considered on a case-by-case basis.	Review the business model and structure chart of the firm or group, including owners and controllers.	TC modified (See paragraph 4.7). Complete automated checks on key controllers. Only complex ownership structures to be investigated.

² As set out in s.61 of FSMA

Threshold Condition	Explanation	Proposed approach for higher-risk firms	Proposed approach for lower-risk firms applying for a limited permission
Appropriate resources	The firm must demonstrate appropriate financial resources, nature and scale of the business and skills and experience of those managing the firm's affairs.	Assess quality and quantity of resources, including financial, management, staff and systems and controls.	TC modified in relation to financial resources. Assess limited basic financial information provided. Firms self-certify factual matters that show they have appropriate management, staff and controls, and that they have sufficient capital to meet debts as they fall due.
Suitability	The firm must demonstrate the competence and ability of management, and that the firm's affairs are conducted in an appropriate manner regarding the interests of consumers and the integrity of the UK financial system.	Review criminal records and other internal intelligence and in some cases consult with trading standards.	Where appropriate, self-certification and automated intelligence checks. Case worker reviews where issues are flagged and on a sample basis.
Business model	The firm's strategy for doing business must be suitable for its regulated activities, have regard to the FCA's operational objectives.	Firms to submit detailed business plan, which is assessed against market norms.	Not applicable (see paragraph 4.7).

'Limited permission' for lower-risk activities

4.6 We consider that firms carrying on certain consumer credit activities are less likely to cause harm to consumers. The Government proposes that these firms should have different, less intrusive authorisation requirements and therefore will be subject to lower application fees (see Chapter 13 for more details on fees).

4.7 The Government proposes that the following activities will be subject to the limited permission regime³:

- credit broking as a secondary activity – for example, motor dealerships and high-street retailers that introduce consumers to a finance provider⁴;
- not-for-profit bodies providing debt advice – for example, Citizens Advice;

³ Persons who carry on the lending, broking and hiring limited permission activities can also apply to carry on, as a secondary activity, debt counselling, debt adjusting and credit information services.

⁴ This activity excludes persons who sell goods or services in customers' homes other than on an occasional basis.

- consumer hire – for example, tool and car hire firms.
- consumer credit lending – where goods and non-financial services are offered directly to purchasers (except hire purchase or conditional sale) on an interest and charges-free basis – for example, golf clubs or gyms allowing deferred payment for membership.

4.8 The Government proposes to apply different TCs for firms carrying on lower-risk activities compared with higher-risk firms. Table 4.1 sets out the proposed approach to TCs for lower-risk firms applying for a limited permission. This will reduce the burden on the firms by significantly reducing the amount of information they have to provide. We also intend to limit the approved persons requirements for these firms.

Authorisation for overseas firms

4.9 Whether or not firms in other European Economic Area (EEA) countries that want to carry on consumer credit activities in the UK need to be authorised will depend on a number of factors. Among the firms that will not need to be authorised are the following:

- Firms that provide their services entirely at a distance by electronic means from an EEA Member State under the E-Commerce Directive (ECD).
- EEA firms, such as credit institutions, operating under certain financial services single market directives⁵ meeting relevant conditions.
- A firm that meets the conditions under Schedule 4 to FSMA.⁶

4.10 Other EEA firms that carry on credit activities and do not have an EEA passport, or that want to carry on other credit activities, will need to apply to the FCA for authorisation. Also, having a UK establishment is important to enable the FCA to effectively supervise credit firms. So we propose that non-ECD, non-passporting EEA firms and EEA firms that do not qualify under Schedule 4 to FSMA should have a UK establishment to be FCA or PRA authorised.

4.11 We propose that all non-EEA firms will need to be authorised by the FCA to carry on consumer credit activities in the UK and will need to have a UK establishment.

Dates and timings applying to become authorised

4.12 We propose that the transfer from the interim permission regime to the full regime should start in the final quarter of 2014.⁷ We are required to decide whether to grant authorisation within six months of receiving a complete application and in any case to decide within 12

⁵ See paragraph 1 of Schedule 3 to FSMA. There are no 'passporting provisions' applicable to EEA firms carrying on *secondary* credit activities (for example, firms providing debt management services) – so even passporting firms will need *additional* permissions to carry on such activities in the UK.

⁶ If a firm established in the EEA is authorised in their home country for the consumer credit activities that they wish to carry on in the UK, they could qualify for authorisation in the UK by demonstrating that the legal provisions of their home country give the equivalent protection to consumers as the Financial Services and Markets Act 2000 (FSMA) does.

⁷ Note – to be finalised based on Government CP.

months of receiving an application.⁸ Firms that have an interim permission and apply for full authorisation in accordance with the timetable set out by the FCA will keep their interim permission until we decide whether they can become authorised.

- 4.13** The FCA will direct firms that have an interim permission or interim variation of permission to apply for full authorisation or variation of permission to the FCA or PRA, as appropriate, in stages from 1 October 2014 (different categories of firms will be directed to apply by a certain deadline). This is to ensure an orderly and efficient transfer.
- 4.14** The Government will consult on its proposals on how applications for consumer credit licences that are being considered by the OFT at the time of transfer will be handled by the FCA.

Approved persons in consumer credit firms

- 4.15** We want to ensure regulated firms are well-run, recognise the risks they face and have appropriate strategies, systems and controls in place. A big part of this involves firms having the right people in important roles in firms.⁹ This section sets out our proposals for vetting individuals to perform functions known as ‘controlled functions’ in consumer credit firms. But the detailed proposed rules will be set out in the autumn CP.
- 4.16** A controlled function is a function performed for a firm by a person, for example, an employee or officer or contractor (such as an appointed representative), while carrying on a regulated activity. An approved person is an individual who will have to be approved by us before they can perform one or more controlled functions.
- 4.17** We propose to vet individuals in key positions in regulated consumer credit firms to ensure they are up to the job and that, once in their role, they are carrying it out effectively. This is known as our ‘fit and proper’ test. When considering a candidate’s fitness and propriety, we propose that we consider, among other things, their:
- honesty, integrity and reputation;
 - competence and capability; and
 - financial soundness.

The approval of an individual complements the regulation of the authorised firm the approved person works for.

- 4.18** When considering whether a firm is fit to hold a consumer credit licence under the Consumer Credit Act, the OFT is required to take account of the conduct of the firm’s employees, agents, associates and controllers, and the skills, knowledge and experience of persons who will participate in the business. However, there is no direct equivalent to the FSA’s approved persons regime.

⁸ See Section 55V of FSMA.

⁹ The detailed rules and guidance in relation to approved persons will be included as part of the consultation scheduled for September 2013.

- 4.19 We appreciate that meeting the requirements of the approved persons regime has cost implications for firms, and we have taken this into account when considering the extent to which we propose to apply the regime to credit firms.

Significant influence functions

- 4.20 Some controlled functions are called ‘significant influence functions’ (SIFs), which is ‘a function that is likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the authorised person’s affairs, so far as relating to the activity’.¹⁰ It is proposed that firms authorised with limited permission will be required to have only one person pre-approved by the FCA for the apportionment and oversight role. Table 4.2 sets out our specific proposals for consumer credit activities.

Table 4.2 Significant influence functions

Significant influence functions	Responsibilities	Our proposals
Governing functions	Direct the firm’s affairs, for example a CEO or non-executive director.	<p>Apply to individuals performing these functions in all authorised firms except:</p> <ul style="list-style-type: none"> • firms with limited permissions; • firms whose main business activity is not a regulated credit activity (most likely firms with limited permissions); • authorised professional firms carrying on regulated credit activity on an incidental basis (for example, law firms that on an incidental basis recover consumer credit related debts on behalf of their clients); • sole traders. <p>Also apply to appointed representatives (except introducer appointed representatives and sole traders - which do not have to have any approved persons). If the appointed representative is carrying on the regulated activity as a secondary activity rather than as a main business activity (for example, an appointed representative motor dealer that is carrying on credit broking as a secondary activity) it only has to have one individual approved for a governing function.</p>

¹⁰ Section 59(7A) FSMA.

Significant influence functions	Responsibilities	Our proposals
Apportionment and oversight function	Ensure that the significant business responsibilities are clearly and appropriately divided among the directors and senior managers of the firm and overseeing the putting in place and maintenance of systems and controls.	<p>Applies to individuals performing this function in the following firms:</p> <ul style="list-style-type: none"> • firms with limited permissions (except for not-for-profit debt advice bodies); • firms whose main business activity is not a regulated credit activity (most likely firms with limited permissions); • authorised professional firms carrying on regulated credit activity on an incidental basis; <p>Firms that fall into the above categories will be required to have one individual approved for the apportionment and oversight function and won't be required to have any other individuals approved.</p> <p>A sole trader would only need a person approved for this function if it is a principal to an appointed representative.</p>
Compliance oversight function	Oversight of the firm's regulatory compliance and reporting to the governing body about that.	<p>Applies to individuals performing this function in the following authorised firms (including sole traders) :</p> <ul style="list-style-type: none"> • debt-management businesses; and • credit repair businesses.
Money laundering reporting officer function	The firm's money laundering reporting.	<p>Applies to individuals performing this function in authorised firms (including sole traders) that are presently covered by the Money Laundering Regulations. It does not apply to 'limited permission lenders'.</p>
Systems and controls functions	Reporting to the governing body of a firm on how it complies with its internal systems and controls requirements and the firm's risk exposure.	<p>Apply to individuals performing these functions in all authorised firms except:</p> <ul style="list-style-type: none"> • firms with limited permissions; • firms whose main business activity is not a regulated credit activity (most likely firms with limited permissions); • authorised professional firms carrying on regulated credit activity on an incidental basis; • sole traders. <p>Responsibility for this function can be assumed by a person already approved to undertake a governing function other than the non-executives.</p> <p>Individuals in firms regulated by both the FCA and the PRA would need to apply to the PRA for approval for the systems and controls function.</p>

Significant influence functions	Responsibilities	Our proposals
Significant management functions.	Only applies to firms where significant responsibility is given to a senior manager of a relatively substantial business.	Apply to individuals performing these functions in all authorised firms except: <ul style="list-style-type: none"> • firms with limited permissions; • firms whose main business activity is not a regulated credit activity (most likely firms with limited permissions); • authorised professional firms carrying on regulated credit activity on an incidental basis; • sole traders. We anticipate that relatively few consumer credit firms will need approval for an individual to perform this function, as in most firms, the individuals approved for the above functions are likely to exercise all the significant influence over the firms' business.
Protecting clients' money and assets	Person responsible for the firms' client asset oversight.	Applies to an individual in a debt management firm (including a sole trader) who is approved for one of the above functions.

Customer function

- 4.21** A customer function normally applies to individuals who deal with customers, or the property of customers, while carrying on a regulated activity. The individual would be required to be an approved person to carry on the activity. However, we are not proposing to apply a customer function to any firms for their consumer credit activities.
- 4.22** As advice is important for debt counselling, we consider that individuals who are approved to undertake the 'compliance oversight' function in debt-management firms and credit-repair firms should be responsible for ensuring the compliance and competence of the firm's advisers. While we believe our proposed approach is appropriate and proportionate, we intend to keep it under review.

Not-for-profit bodies providing debt advice

- 4.23** We are proposing that not-for-profit bodies providing debt advice should not have to have any approved persons. We consider that it would be disproportionate to require these advice providers to have approved persons given the relatively lower risk associated with providing debt advice where the provider has no profit-seeking incentive.
- 4.24** In reaching this view, we have also taken account of the work currently being undertaken by the Money Advice Service to develop a Quality Framework (QF) to set a benchmark for delivering debt advice and improving the consistency of standards. The QF will set out a minimum range of skills, knowledge and competencies for debt advisers.

¹¹ This function also applies to common platform firms.

- 4.25 However, we do propose that each authorised provider of not-for-profit debt advice should have a named individual responsible for dealing with any concerns we raise.

Appealing against our decision

- 4.26 We will tell a firm if we intend to refuse its application for authorisation, limited permission or approval of an individual. The firm then has an opportunity to put forward its position before we make our final decision. The firm would also be able to withdraw its application before it is refused.
- 4.27 There is an appeal process for firms that do not agree with our decision, which allows cases to be heard in front of an independent committee and then a tribunal.

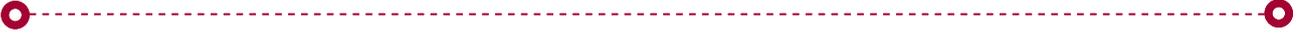
Summary of our proposals

- The transfer from the interim permission regime to the full regime should begin in the final quarter of 2014.
- We will direct firms that have an interim permission or interim variation of permission to apply for full authorisation in stages from 1 October 2014.
- We will decide on applications within six months of receiving a complete application and in any case within 12 months of receiving an application.
- Firms must demonstrate that they satisfy at the time of authorisation, and will continue to satisfy as long as they are authorised, the minimum standards set out in legislation, called the Threshold Conditions. Our proposals are set out in Table 4.1.
- Firms carrying out specified lower risk activities will be subject to lower threshold conditions and lower cost authorisation.
- Some firms based in EEA countries will not have to apply for authorisation to carry on a regulated consumer credit activity. Others will need authorisation from us or PRA as appropriate.
- Firms will be notified of our intention to refuse an application and will be able to appeal before a final decision is made.
- Individuals performing certain functions for authorised credit firms (excluding sole traders) will need to be pre-approved by us. Table 4.2 sets out our proposals.

Q5: Do you agree that we should apply the Threshold Conditions as proposed?

Q6: Do you agree that we should apply the approved persons regime activities as proposed?

Q7: Do you agree with our proposal not to apply a customer function to any consumer credit activity, particularly debt advice?



5

Alternatives to authorisation

The Government proposals include lower-cost alternatives to authorisation, with fewer regulatory requirements for firms that are carrying on certain consumer credit activities and/or meet specified criteria.

This means that a number of firms (smaller ones in particular) will be able to continue to carry on their credit-related business activities when they might not otherwise have been able to do so. This helps to minimise any adverse impacts on competition.

5.1 In Chapter 4 we set out our proposed general approach to authorising firms that are carrying on consumer credit activities. In this chapter we set out some of the possible alternatives to becoming authorised that will be available to some firms, such as:

- being an appointed representative of an authorised firm;
- being a self-employed agent of an authorised home collected credit firm; and
- being an ‘exempt professional firm’.

Appointed representatives

5.2 To carry on regulated activities, firms under the FCA regime will either have to be authorised or ‘exempt’ from becoming authorised.¹ A firm can be exempt if it is an appointed representative of an authorised firm. An appointed representative is a firm that has a contract with an authorised firm, known as ‘the principal’, under which the principal accepts responsibility for the appointed representative carrying on regulated activities. The appointed representative has no direct relationship with the regulator (the FCA) on an ongoing basis.

5.3 Becoming an appointed representative may be of particular interest to small firms carrying on higher-risk credit activities if they do not want to pay the full cost of

¹ It is generally the case that firms cannot be both authorised *and* exempt. However, the Government is proposing that firms can hold a limited permission for certain lower-risk credit activities (see Chapter 4) and also be appointed representatives for other FSMA-regulated activities.

- authorisation or do not have the infrastructure or internal systems and controls to become authorised firms themselves.
- 5.4 Being a principal is most likely to appeal to firms that rely on intermediaries to find, or deal with, customers on their behalf. For example, some lenders might want to be principals to credit brokers, who would act as their appointed representatives. A principal would be required to monitor the quality of service being provided by an appointed representative that is acting as its intermediary.
- 5.5 The Government is proposing that most consumer credit firms should have the option to become an appointed representative of an authorised firm under the FCA regime. However, becoming an appointed representative or a principal would, at most, only ever be an option. It would never be mandatory.
- 5.6 The option of being an appointed representative would not be available to lenders. They cannot become appointed representatives of other credit firms because, under the Consumer Credit Directive, they are not allowed to be supervised by other consumer credit firms.²
- 5.7 Credit reference agencies (CRAs) provide information on the credit history of consumers. CRAs have a central role in the credit sector because they hold extensive data that is used by creditors to inform responsible lending decisions. The Government is proposing that, given the importance of their role, CRAs should be directly supervised by the FCA and should not have the option to become appointed representatives.
- 5.8 An ‘introducer appointed representative’ is a type of appointed representative whose activity is limited to introducing customers to its principal and distributing non-real time financial promotions.³ If an appointed representative’s activities go beyond these limitations and it, for example, provides advice to customers, it cannot be an introducer appointed representative. Because the activities that an introducer appointed representative can carry out are limited, it is subject to fewer rules than other appointed representatives. It is also not required to have any approved persons. We propose that the FCA will adopt this approach to introducer appointed representatives in the credit sector.

Multi- and single-principal arrangements

- 5.9 Under a ‘multi-principal arrangement’, an appointed representative may have contracts with a number of different principals, each of which will be an authorised firm. The appointed representative must have a separate agreement with each principal. A ‘multiple principal agreement’ should also be in place between all of the principals to the same appointed representative. This will set out how any potential conflict of interest is managed and how any consumer complaints about the appointed representative should be dealt with (and by whom).

² Article 20 of the Consumer Credit Directive (CCD) requires Member States ‘to ensure that creditors (lenders) are supervised by a body or authority independent from financial institutions or regulated’. This means that if a person wants to provide credit (of a type covered by the CCD), that person must be regulated by the FCA or supervised by an independent authority. It cannot be an appointed representative of another firm.

³ A ‘non-real time financial promotion’ is a promotion that is not made in the course of a personal visit, telephone conversation or other interactive dialogue.

- 5.10 Multi-principal arrangements allow appointed representatives to access goods or services for their customers from each principal. So, allowing appointed representatives to enter into multi-principal arrangements increases the choices available to consumers. Allowing for such arrangements would also take into account our desire, where possible and appropriate, not to disrupt existing market practice. Under ‘single-principal arrangements’ an appointed representative is only permitted to have *one* authorised firm as its principal. They do not allow for the same degree of consumer choice, but potentially enable more effective systems and controls to be put in place between the principal and its appointed representative and make it clearer which authorised firm is responsible if any problems arise with the appointed representative.
- 5.11 In considering whether to allow for multi-principal arrangements, we have thought about the potential impact on:
- the operation of the relevant market;
 - consumer choice;
 - consumer protection and well-being; and
 - the principal’s ability to operate effective systems and controls.
- 5.12 We propose that appointed representatives of consumer credit firms should be able to enter into multi-principal arrangements – unless they are debt collectors.
- 5.13 Debt collection businesses act on behalf of lenders to collect debts owed by consumers – not on behalf of the consumers who owe the debts. So, it is important that it is clear to consumers which lender a debt collector is acting for. It would be less clear if a debt collection firm had more than one principal. So appointed representative debt collection firms would only be allowed to enter into single-principal arrangements.

Self-employed agents

Home collected credit firms

- 5.14 Home collected credit firms supply small, short-term, unsecured loans direct to customers in their homes. It is common practice in this sector for some of the larger firms, in particular, to deal with their customers via self-employed agents. Self-employed agents are not paid a salary by an employer. These agents call on customers in their homes to provide loans or collect repayments due on loans, on behalf of the home collected credit providers they represent, and they receive commission on the repayments they collect.
- 5.15 Agents of home collected credit firms may:
- introduce new clients to the credit provider;
 - arrange for the completion of the relevant credit agreements by new clients; and
 - collect repayments.

- 5.16 The OFT currently views self-employed agents of home collected credit firms as carrying on activities for the credit provider as if they are employees. So it allows them to operate under the credit provider's licence. Similarly, where self-employed agents meet certain specified criteria, we consider that they should be regarded as carrying on the business of the home collected credit firm they are representing, rather than carrying on their own business. We consider, therefore, that such self-employed agents will not need to be authorised or appointed representatives of the credit provider (provided that the credit provider is an authorised firm). However, under such circumstances, the FCA will hold the credit provider fully responsible for the conduct of its agents when they are carrying on business on the credit provider's behalf.
- 5.17 We propose that our Perimeter Guidance⁴ will set out the features of the relationship between the agent and the home collected credit provider (its 'principal') that are relevant to determine whether the agent is carrying on activities for the principal's business (rather than the agent's own business).
- 5.18 Although the overall relationship between a home collected credit provider and its agent will need to be taken into account, our current thinking is that meeting the following criteria is more likely to mean that the agent is carrying on the business of the credit provider:
- the principal appoints the agent as an agent;
 - the agent only works for one principal;
 - the agent is not paid a commission for recruiting new borrowers;
 - the principal has a permission from the FCA for every activity the agent is carrying on for which the principal would need permission if it was carrying on the activity itself;
 - the contract sets out measures for the principal to control the agent;
 - the principal accepts full responsibility for the conduct of its agent when it is acting on its behalf in the course of its business; and
 - the agent makes clear to customers the name of the principal that it is representing.

Mail order firms

- 5.19 Mail order firms supply goods to their customers by mail delivery. Their customers order goods, often on credit terms, through some remote method such as a website, and the products are then delivered to the customers' homes.
- 5.20 However, arrangements between mail order firms and their agents are different to those between home collected credit providers and their agents. For example, many agents of mail order firms are in reality more like 'preferred customers' who receive discounts similar to 'cashback' payments on purchases they make for themselves and on behalf of friends. Self-employed agents of home collected credit providers tend to act in more of a 'formal' capacity on behalf of the credit provider firms they represent.

⁴ The Perimeter Guidance gives guidance about the circumstances in which a firm is required to be authorised and where the option of being an exempt person is available.

- 5.21 Agents of mail order firms who canvass agreements off trade premises are currently exempted from credit brokerage and certain other ancillary credit activities in specified circumstances and are not, therefore, required to hold consumer credit licences. The Government proposes to carry forward that exemption in the Regulated Activities Order so that in similar circumstances agents of mail order firms will be outside the scope of FCA regulation.

Exempt professional firms

- 5.22 Under Part 20 of FSMA, members of Designated Professional Bodies (DPBs), known as exempt professional firms (EPFs), can carry on certain regulated activities while being supervised and regulated by their DPB instead of the FCA if they meet certain conditions, including:

- the activities must arise out of, or be complementary to, other professional services provided to the client;
- the activities must be incidental to the provision by the firm of professional services⁵;
- the DPB member must account to its client for any pecuniary reward or other advantage (for example commission) received from anyone other than the client; and
- the DPB has made rules governing these activities and those rules have been approved by the FCA.

- 5.23 The ten professional bodies currently designated by Government as DPBs for this purpose are:

- the Law Societies of Scotland, Northern Ireland, and England and Wales;
- the Association of Chartered Certified Accountants, and the Institutes of Chartered Accountants in England and Wales, Ireland and of Scotland; and
- the Council for Licensed Conveyancers, Royal Institution of Chartered Surveyors, and the Institute and Faculty of Actuaries.

- 5.24 These ten DPBs include seven law and accountancy professional bodies whose members currently carry on regulated consumer credit activities under an OFT ‘group’ consumer credit licence. The Government is proposing that members of these DPBs can undertake consumer credit activities under the FSMA Part 20 regime if they satisfy its conditions.

- 5.25 The FCA will have ongoing responsibility for the oversight of the DPBs. This will include deciding whether to approve the rules proposed by the DPBs for governing the consumer credit activities of their members and approving any changes to those rules. DPBs whose members currently benefit from an OFT group licence and who want their members to benefit from the Part 20 regime will need to ensure they have rules approved by the FCA that govern the consumer credit activity of their members in place by 1 April 2014.

- 5.26 Firms and/or individuals that fail to meet the FSMA Part 20 conditions will have to obtain FCA authorisation (unless they are otherwise exempt). So, for example, firms that

⁵ See PROF 2.1.14 G for guidance as to what might constitute “incidental activity”. <http://fsahandbook.info/FSA/html/handbook/PROF/2/1>.

provide services in the course of carrying on regulated consumer credit activities in a way that is not incidental to the provision by that firm of professional services are likely to have to be authorised. If such firms are already EPFs for other FSMA-regulated activities, it is likely that they will also have to become authorised for those activities. This is because the carrying on of a regulated activity by a firm cannot be exempt under FSMA Part 20 if the firm is required to be authorised for other regulated activities.

- 5.27** However, such authorised firms and/or individuals are very likely to fall within the category of Authorised Professional Firm, which also potentially offers some rules modifications which may reduce their regulatory burden.

Summary of our proposals

- The option of being able to enter into multi-principal arrangements should be available to appointed representatives carrying on any consumer credit activities, except for third-party debt collectors.
- Self-employed agents of home collected credit firms and mail order firms meeting certain criteria will not need to be authorised by the FCA or to become appointed representatives.

Q8: Do you agree with our proposed approach to appointed representatives and multi-principal arrangements?

Q9: Do you agree with our proposed approach to self-employed agents?

Q10: Do you agree with our approach to professional firms?

6

Prudential standards for debt management firms

- All FCA-authorized firms will be required to hold appropriate financial resources. But, as debt management firms pose particular risks that can cause significant harm to consumers, we propose that they should also hold a minimum level of capital. This will have several advantages for consumers, including:
 - if a firm were to fail, these financial resources will aid an orderly wind-down;
 - firms having some financial resources to help cover costs if they fail to comply with our rules; and
 - firms having enough financial resources to pay redress to consumers.

Introduction

- 6.1** This chapter describes the prudential standards that we are proposing for debt-management firms.¹
- 6.2** Firms that are not subject to our prudential standards will still have to “maintain adequate financial resources”.² This includes having to hold enough money so that their debts can be paid off as they fall due. All FCA-authorized firms must also comply with the threshold conditions³, which include requirements beyond meeting liabilities and take account of the incidence of risk in connection with a firm’s business.⁴ Failure to comply with these requirements could result in enforcement action.

What are prudential standards and why are they important?

- 6.3** Prudential standards have two key elements: prudential requirements and prudential resources. Prudential requirements refer to obligations to hold certain amounts of specified

¹ This excludes not-for-profit bodies providing debt advice.

² See PRIN 4 “A firm must maintain adequate financial resources.”

³ The threshold conditions are proposed to be amended by the Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013, Condition 2D is currently paragraph 4 in Schedule 6 to FSMA.

⁴ The issue of whether a firm has “appropriate financial resources” is modified for firms with a “limited permission” (see Chapter 4); such a firm must be capable of meeting its debts as they fall due.

- financial resources for regulatory purposes; prudential resources describe what financial resources a firm actually holds. Comparing the amount of prudential resources a firm holds with its prudential requirement tells us if a firm is meeting its prudential requirement or not. Prudential requirements can take a number of forms, including capital requirements, liquidity requirements, professional indemnity insurance and ratios such as a leverage ratio.
- 6.4 Prudential standards are important because they aim to minimise the risk of harm to consumers by ensuring that firms behave prudently in monitoring and managing business and financial risks and hold suitable financial resources. Experience tells us that if a firm is in financial difficulty or it fails it can cause harm and disruption for consumers. For example, a firm under financial/prudential strain is more vulnerable to behaving in a way that increases the probability of consumers suffering loss. In this way, prudential standards support the FCA's statutory objectives and conduct responsibilities of firms through aiming to ensure that firms have enough financial resources to cover operational and compliance failures and/or pay redress.
- 6.5 The FCA approach document '*Journey to the FCA*' outlines the FCA's prudential vision⁵ and how the FCA prudential approach will aim to minimise the risk of consumer harm as a result of firms being under financial stress, while also improving the strength and integrity of the financial system.

Why are we proposing that only debt management firms are subject to prudential standards?

- 6.6 When developing our proposals we weighed up the harm that consumers might face if a consumer credit firm was under financial stress, against the cost to firms of introducing prudential requirements.
- 6.7 In terms of harm, we consider that debt management businesses pose a high risk to consumers because they may hold and/or control clients' money (i.e. debt repayments), before passing them on to the customers' creditors. Firms holding client money typically need more time to wind down. Having prudential resources gives them time during which they can continue providing their services while updating and transferring records, thereby improving the opportunity for a more orderly wind-down.
- 6.8 Furthermore, the potential for debt-management firms to pay redress, in comparison to other consumer credit firms, is increased because they provide advice to some of the most vulnerable consumers in the financial services market. There is, therefore, a high risk of harm if consumers receive poor advice, such as inappropriate debt solutions, and/or the firm fails.
- 6.9 We considered applying capital requirements for lenders, as consumers may be indirectly harmed if a lender fails and future services from the lender are disrupted. However, we found it harder to justify the proportionality of this.

⁵ See page 33 of the FCA approach document '*Journey to the FCA*' available at: <http://www.fsa.gov.uk/static/pubs/other/journey-to-the-fca-standard.pdf> for further details on the FCA prudential approach.

Developing our prudential standards for debt management firms

- 6.10** Prudential requirements can take a number of forms, including capital requirements, liquidity requirements, professional indemnity insurance and prudential ratios such as a leverage ratio. Our current thinking is to introduce a capital requirement for debt management firms, which will apply when they become fully authorised.⁶
- 6.11** Typically a firm would hold the higher of a ‘flat base requirement’ and a ‘variable, volume-based requirement’, which we would normally determine using volume-based measures, such as turnover. However, we are assessing whether there are better measures than turnover so we can ensure that firms posing greater risks to consumers have to hold more capital. The ‘risk-sensitive volume-based measures’ that we are considering are:
- a percentage of the size of debt contracts the firms is negotiating; or
 - a percentage of the amount of client money it holds; or
 - a combination of the above.
- 6.12** Our indicative thinking is that firms will have to hold financial resources such as share capital, retained earnings and subordinated debt to meet their prudential requirement (see Table 6.1).
- 6.13** We are currently analysing a sample of debt management firms to understand their business models and funding structures. This work will help to determine our final prudential standards proposals. For the purpose of the cost benefit analysis (see Annex 3), it is assumed that debt management firms would be required to hold capital equal to 2.5% of turnover with a minimum of £5,000.

Table 6.1: Summary of our indicative thinking on prudential standards for debt management firms

Capital requirement	Higher of: <ul style="list-style-type: none"> • fixed minimum amount; and • percentage of a volume-based measure (such as size of debt contracts being negotiated and/or amount of client money).
Capital resources	The total of: (A firm’s share capital, plus its profit and loss account, its other reserves and its eligible subordinated debt/loans) minus its investments in its own shares, its intangible assets and its interim net losses.

⁶ So it does not apply during the interim permission regime.

Summary of our proposals

- We propose to introduce a prudential requirement for debt management firms.
- This is likely to involve firms being required to hold the higher of a fixed amount of prudential resources or a variable volume-based amount.
- We will continue work to understand the most appropriate prudential standards for debt management companies.

Q11: Do you agree with our proposal to apply prudential standards to debt management firms only?

Q12: Are there any difficulties in collecting data on the size of debt contracts being negotiated and/or the amount of client money being held (as the basis for our prudential standards)?

Q13: Are there other measures that would ensure our prudential regime for debt management firms targets the firms that pose the greatest risk to consumers?

7

Conduct standards

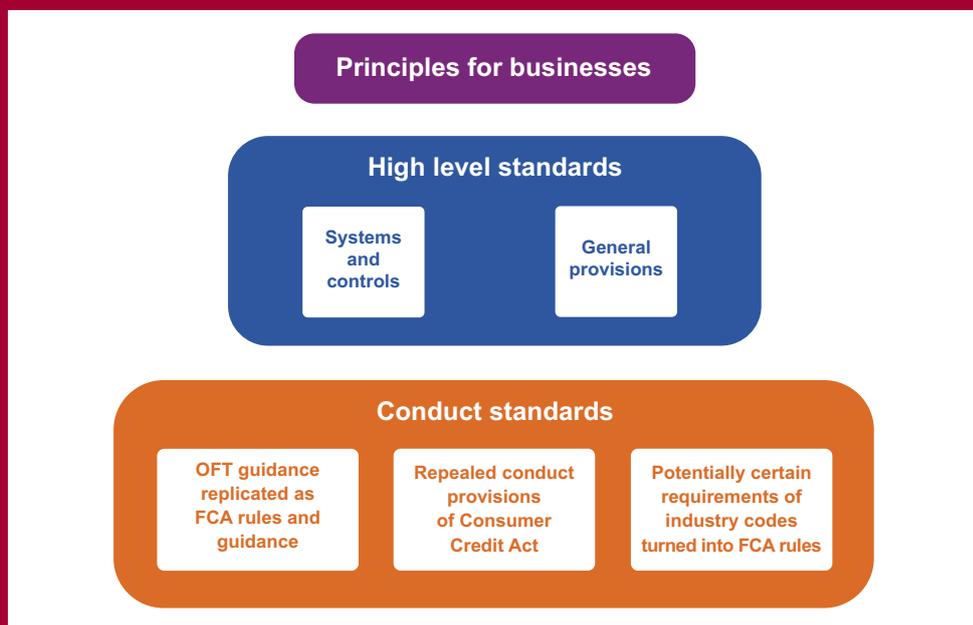
We propose a tiered framework of high-level standards and more detailed conduct standards:

- The Principles for Businesses: establish the principles for behaviour that we require from firms, applicable to all their consumer credit activities.
- Other high-level standards: setting standards for how firms should organise and manage their affairs, including the Senior Management Arrangements and Systems and Controls.
- Conduct standards: setting detailed standards for how firms should conduct themselves with their customers. These will be based on the current conduct standards set out in the CCA and OFT guidance. Guidance will be strengthened and given the status of rules where appropriate.

Benefits of the proposals:

- Firms and consumers will have a clear statement of the standards of behaviour we expect from firms.
- Firms must be able to demonstrate to us that their internal systems and controls meet our requirements. We expect this to drive up standards.
- The current conduct standards will continue to provide protections for consumers and will be familiar for firms, but with guidance given the force of rules where appropriate.

Table 7.1 – FCA rules



7.1 This chapter contains the following sections:

Section 1: The Principles and other high-level standards

7.2 We propose to apply rules in the following areas, setting out the overarching standards that firms must meet:

- i) the Principles for Businesses – the fundamental obligations of firms under the FCA regime;
- ii) systems and controls rules – the high-level rules setting out how firms should organise and manage their affairs; and
- iii) general provisions on matters such as how firms describe their regulated status.

7.3 The proposed draft rules and guidance¹ can be found in Appendix 1. These need to be read in conjunction with the rules in the relevant modules of the FCA Handbook (Table 7.2).

Section 2: Conduct standards

7.4 We propose that the provisions relating to conduct standards set out in the CCA and in OFT guidance will form the basis of our own conduct rules and guidance.

7.5 Draft rules and guidance will be included in the autumn Consultation Paper.

Section 3: Industry codes

7.6 We describe how industry codes may interact with our conduct regime.

Table 7.2 – FCA rules and guidance

FCA rules and guidance

We have the power to make rules that are legally binding on firms. Breaching rules can lead to enforcement action and, where applicable, a claim for damages from a customer. Before making rules, we must consult publicly on the draft rules and publish a cost benefit analysis of the impact of the proposals. The Government's draft legislation includes special provisions that say the requirement to carry out a cost benefit analysis does not apply to proposed FCA or PRA rules that are substantially the same as any of the provisions of the CCA or OFT guidance.

After we have consulted, final rules are made by our Board and published shortly afterwards in a rule-making instrument, which is incorporated into our online Handbook. A Policy Statement is published at the same time, explaining how we have responded to consultation feedback.

We also have the power to issue guidance on our rules. Guidance indicates possible ways for a firm to comply with a rule, recommends a particular course of action or gives information about how we will interpret a rule in certain circumstances. Guidance is not binding and failing to follow it need not mean a rule has been breached. We must also consult on this guidance, although we do not have to publish a cost benefit analysis. Guidance is published in our Handbook or elsewhere on our website.

¹ The draft rules include some rules to be made jointly with the PRA or by it alone.

- **The FCA Handbook of rules and guidance**

Rules and guidance are set out in the Handbook. It is divided into blocks and each block into modules. The Handbook also has a glossary containing all the definitions used in it. More information on the Handbook can be found in the **Readers Guide**.

The draft high-level rules we are consulting on in this CP will be included in 'Block 1 – High Level Standards'. Additions and amendments to the glossary are also proposed. Acronyms are used to abbreviate the titles of modules in the Handbook and are used at the beginning of the rule number to identify its location in the Handbook, e.g. SYSC is the abbreviation for the Senior Management Arrangements, Systems and Controls module.

We expect to create a new module of the Handbook for the consumer credit conduct rules and guidance that we intend to consult on in the autumn.

- **Waivers**

Firms may apply for a waiver from an FCA rule, or a modification so they can comply with an amended rule that better fits their own circumstances. Not all rules can be waived or modified (for example, rules that implement European Directive requirements) and applications must meet both elements of the relevant statutory test, which are:

(i) if the firm complies with the rule as it stands it would cause an undue burden OR the rule would not achieve the purpose it was made for; and

(ii) waiving or modifying a rule would not stop the FCA from achieving any of our statutory objectives (regarding consumer protection, integrity and competition).

Section 1 – The Principles and other high-level standards

The Principles for Businesses

What are the Principles for Businesses?

- 7.7 The Principles for Businesses (the Principles) are a general statement of the fundamental obligations that firms must comply with under the regulatory system. In our Handbook, they are referred to as 'PRIN' for short. The Principles are rules and firms must comply with them at all times². We can take enforcement action if they are breached by a firm³.
- 7.8 We propose to apply the Principles to all authorised consumer credit firms and those with limited permission. As well as setting out our overarching expectations of firms, they form the basis for other more detailed rules and guidance. They will also apply to ancillary activities⁴ of consumer credit activities, for example, where a credit broker provides generic advice, which is not a regulated activity.
- 7.9 We propose to apply them from 1 April 2014.

² Although the Principles do not apply to the extent that it would be inconsistent with EU law such as the Consumer Credit Directive.

³ A contravention of the Principles does not give rise to a private action for damages.

⁴ An ancillary activity is defined as one which is not a regulated activity but which is: a) carried on in connection with a regulated activity; or b) held out as being for the purposes of a regulated activity.

Table 7.3 – The Principles for Businesses

The Principles for Businesses		
1	Integrity	A firm must conduct its business with integrity.
2	Skill, care and diligence	A firm must conduct its business with due skill, care and diligence.
3	Management and control	A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk-management systems.
4	Financial prudence	A firm must maintain adequate financial resources.
5	Market conduct	A firm must observe proper standards of market conduct.
6	Customers' interests	A firm must pay due regard to the interests of its customers and treat them fairly.
7	Communications with clients	A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
8	Conflicts of interest	A firm must manage its conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9	Customers: relationships of trust	A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely on its judgement.
10	Clients' assets	A firm must arrange adequate protection for clients' assets when it is responsible for them.
11	Relations with regulators	A firm must deal with its regulators in an open and co-operative way, and must disclose to the FCA appropriately anything relating to the firm of which the FCA would reasonably expect notice.

Changes for consumer credit firms

7.10 Consumer credit firms will, for the first time, have a single set of rules setting out the broad parameters of expected behaviour. Currently, the OFT assesses whether a person applying for a consumer credit licence is a 'fit' person. It takes into account a number of factors, some of which are similar to the Principles. OFT guidance also refers to similar concepts to those used in the Principles. For example, the OFT states in its guidance that borrowers must be treated fairly.⁵ The CCA also requires the OFT to consider whether licensees have the skills, knowledge and experience to carry out the activities covered by a licence when considering their fitness.⁶

7.11 So, although the effect of the Principles for Businesses may be new or different in some ways, we would expect well-managed, compliant businesses to find much that is familiar. One difference for some firms may be the requirement in Principle 3 for 'adequate risk management systems', and our CBA work identified this as an area where some firms were not confident they would meet the standard (see Annex 3). The requirement for firms to maintain adequate financial resources will also be new for many consumer credit firms. The Principles are a set of binding rules, whereas some of the similar provisions in the CCA regime is OFT guidance, albeit that the guidance is taken into account in decisions on fitness.

How the Principles work with European Directives

7.12 Some European Directives apply to consumer credit activities, in particular the CCD. Some Directives (including the CCD) do not allow member states to make rules that go beyond

⁵ See, for example, paragraphs 2.2. and 2.3 of the Irresponsible Lending Guidance.

⁶ See section 25(2)(a).

their requirements (i.e. they are ‘maximum harmonising’), and we set out in the Handbook where this is the case.⁷

Draft amendments to the Principles

- 7.13 We do not need to make a new rule to apply the Principles to consumer credit firms – they apply to all FCA-regulated activities, unless we exclude them. However, some minor drafting amendments are needed to adapt the Principles to consumer credit activities. For example, the Principles will apply to activities ancillary to credit regulated activities. The draft rules are set out in Appendix 1.

Senior management arrangements, systems and controls

What are senior management arrangements, systems and controls?

- 7.14 The senior management arrangements, systems and controls (systems and controls rules) are rules and guidance that expand on Principle 3. This states ‘A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems’. They can be found in the Senior Management Arrangements, Systems and Controls module of the Handbook (known as SYSC).
- 7.15 The systems and controls rules describe what the FCA will expect, in practice, when complying with Principle 3. They aim to ensure that those in charge of firms take appropriate responsibility for how the firm carries on its business, including acting in a way that enables us to properly monitor its business and that it conducts its affairs adequately and responsibly.
- 7.16 We propose to apply our systems and controls rules and guidance to all authorised consumer credit firms and those with limited permission. The table gives some examples of the types of area covered and examples of rules and guidance under that area:

Table 7.4 – examples of rules and guidance

Example of area	Example of rule
General Organisational Requirements (SYSC 4)	A firm must have robust governance arrangements
Employees, agents and other relevant persons (SYSC 5)	A requirement that a firm employs personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.
Compliance, internal audit and financial crime (SYSC 6)	A requirement that a firm must allocate, to a director or senior manager, overall responsibility within the firm for the establishment and maintenance of effective anti-money laundering systems and controls.
Record-keeping (SYSC 9)	A requirement that a firm keeps sufficient records of its business to enable the FCA to monitor the firm’s compliance.

- 7.17 We propose that the rules and guidance will apply from 1 April 2014.

⁷ PRIN 3.1.6R.

- How the systems and controls rules will apply to different types of firm**
- 7.18** Our systems and controls rules differ according to whether or not a firm is subject to rules for certain activities (other than consumer credit activities) because it poses potentially significant risks to the financial system, such as banks and building societies. These firms are called ‘common platform firms’ in our rules. For other firms (including all consumer credit firms not currently FSA regulated), many of the rules will not apply, but are instead guidance for firms to take into account. For example, while a common platform firm must ensure that its senior personnel receive written reports on various matters at least annually, other firms should consider adopting this practice in order to comply with more general requirements.
- 7.19** Our expectation of the types of systems and controls that a firm must have in place will reflect the nature, scale and complexity of the firm’s business and the risk the activity potentially poses to consumers.
- 7.20** We do not expect a small lender dealing with a small number of customers to have the same systems and controls as a major lender or large debt collection business. Table 7.5 sets out an example of how we take a proportionate approach to interpreting firms’ responsibilities under the rules.

Table 7.5 – Proportionality

Rule 6.3.1: ‘A firm must ensure the policies and procedures established under SYSC 6.1.1 R include systems and controls that:

- (1) enable it to identify, assess, monitor and manage money laundering risk; and
- (2) are comprehensive and proportionate to the nature, scale and complexity of its activities.’

Many small firms will receive advice and support from their trade associations to manage their money laundering risk. If this is the case, we will expect them to have a mechanism in place for monitoring and implementing any updates from their trade association.

Large firms are much more likely to have their own compliance function. In these cases, we would expect the internal compliance function to ensure that the firm complies with our requirements.

Changes for firms from the current regime

- 7.21** The current CCA regime does not have a direct equivalent to the systems and controls rules. However, in a number of ways, the requirements of the rules are reflected in how the OFT determines if a firm is fit to hold a consumer credit licence: in its Guidance on Consumer Credit Licensing, the OFT states that it will take into account any circumstances that appear to it to be relevant when assessing fitness, including the practices and procedures that the applicant proposes to operate in running the business.
- 7.22** However, there are differences between the CCA regime and the requirements under the systems and controls rules. For example, the proposed requirement on a firm (other than a sole trader) to appoint a Money Laundering Reporting Officer⁸ is a different and wider role

⁸ See SYSC 6.3.9.

to that required under the Money Laundering Regulations 2007 alone. The proposed rules would apply to a firm covered by the Money Laundering Regulations. This proposal is discussed further in Chapter 12. Breach of the systems and controls rules can also give rise to a wider range of sanctions than is the case under the CCA regime.

- 7.23 Our CBA work (see Annex 3) also identified the requirement for orderly record-keeping that enables us to check firms' compliance with our rules. This could be an area where some firms need to make changes and will incur some costs in improving their record-keeping.

Draft rules and guidance

- 7.24 We do not need to make a new rule to apply the systems and controls rules to consumer credit firms – they apply to all FCA-regulated activities, unless we exclude them. However, some amendments need to be made to adapt them for consumer credit activities, for example, the Principles and systems and controls rules will apply to ancillary activities to credit regulated activities. Appendix 1 sets out the proposed draft rules.

General provisions

What are the general provisions?

- 7.25 The general provisions contain a number of rules relating to mainly administrative duties. They describe:
- how firms authorised by the FCA must describe their regulatory status: 'status disclosure';
 - a prohibition on firms claiming or implying that their business is endorsed by the FCA;
 - how to interpret the FCA's Handbook of rules and guidance;
 - restrictions on using the name of the FCA and its logo; and
 - the ban on insurance against financial penalties.

Status disclosure and referring to approval by the FSA

- 7.26 Firms should make clear to consumers who they are regulated by and whether they have an interim permission, are authorised or have limited permission. The required statement must be included on every letter (or electronic equivalent) sent to a consumer in relation to consumer credit activity. However, in some cases, the rules cannot be applied because of the CCD.
- 7.27 The draft rules set out the required statements that firms must include on their correspondence. Firms do not have to contact all of their customers to inform them that there has been a change in their regulator, but they must ensure correspondence after 1 April 2014 includes the required statement and that pre-contract information and agreements entered into after 1 April 2014 properly describe the regulator. We will work with the Government to develop proposals for handling any transitional issues that arise.

- 7.28 The draft rules propose an amendment that where a firm with a limited permission refers to its regulated status it must explain in a fair, clear and not misleading way that its authorisation was granted under the limited permission procedure.
- 7.29 The rules in GEN 1 which prohibit firms from claiming or implying that their business is endorsed by the FCA are proposed to apply to consumer credit firms. Some minor technical amendments are required to these rules to adapt them to consumer credit.
- 7.30 The proposed draft rules are set out in Appendix 1. They take account of our recent consultation on changes to the general provisions.

Other general provisions

- 7.31 We propose that these rules will apply without amendment. The rules can be found in the general provisions section of the Handbook of rules and guidance (known as ‘GEN’). The key provisions are, in broad terms:
- how firms should interpret the Handbook (GEN 2);
 - firms may not use the FCA logo other than as part of a statement about their regulated status (GEN 5);
 - firms (except sole traders) may not pay financial penalties imposed on an employee or director by the FCA (GEN 6); and
 - firms may not insure themselves against financial penalties imposed by the FCA.
- 7.32 We propose that the general provisions apply from 1 April 2014.

Training and competence

- 7.33 For some regulated activities, we have high-level rules relating to training and competence and rules requiring qualifications for certain activities. We do not propose to apply these rules to consumer credit activities, but will instead rely on the Principles and systems and controls rules to establish the high-level standards firms must meet.
- 7.34 The relevant Principles and systems and controls rules are:
- Principle 3 – Management and control: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
 - Principle 9 – Customers: relationships of trust: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely on its judgement.
 - SYSC 5.1.1R: “A firm must employ personnel with the skills, knowledge and expertise necessary for the discharge of responsibilities allocated to them”.

Summary of our proposals

We propose to apply the FCA's Principles for Businesses, systems and controls rules and guidance and general provisions.

We propose not to apply the training and competence rules to consumer credit activities, but instead will rely on the Principles and systems and controls rules to ensure firms employ personnel with the necessary skills, knowledge and expertise.

Q14: Do you agree with our proposals that the new requirements should apply from 1 April 2014?

Section 2: Conduct standards

Carrying across CCA and OFT conduct standards to the FCA regime

- 7.35** We propose to bring across broadly the same conduct standards into our regime from the current regime.
- 7.36** There are numerous requirements in the CCA and associated regulations that provide important protections for consumers. They set out in detail how firms should behave, such as the information they need to give to their customers. The Government want to maintain equivalent protections for consumers after the transfer. We support this and propose that CCA conduct provisions are made into FCA rules.
- 7.37** There are, however, a substantial number of provisions in the CCA which we cannot replicate in an equivalent way in our rules because of the limitations of our rule-making powers. Where we cannot replicate the protections in our rules, the Government is proposing that the relevant provisions are retained in the CCA for the time being. The FCA will be responsible for enforcing those provisions using its powers under FSMA.
- 7.38** In addition, the OFT has issued a large amount of detailed guidance for consumer credit firms on the standards of conduct it expects of them. We propose that the substance of this OFT guidance should, where appropriate, also be turned into FCA rules and guidance.
- 7.39** Where we see risks for consumers because of gaps in our rules, we will consult on amending or adding rules. For example, we will work with the OFT in the light of their payday lending compliance review and their continuing work on problems in the debt management market and will act to make new rules in these areas if necessary.

Our approach to replicating the CCA rules and OFT guidance

CCA

- 7.40** The Government has proposed which parts of the CCA will be kept for the time being. We propose that conduct provisions which will be repealed are turned into FCA rules. We will consult on draft FCA rules in autumn 2013. We will try to minimise changes from the current CCA drafting, but in some cases, changing the terminology will be unavoidable. For example, terms such as ‘creditor’ and ‘debtor’ will be replaced by ‘lender’ and ‘borrower’, because this is how the Government proposes they should be described in their legislation (bringing them into line with terminology in FSMA).
- 7.41** In relation to the retained provisions of the CCA, the Government has further proposed that we must conduct a review of whether the repeal of these provisions would adversely affect appropriate consumer protection. The review must be completed by 1 April 2019.

OFT guidance

- 7.42** As well as the provisions in the CCA, the basis of our conduct regime will be the principles set out in the OFT’s guidance on how it determines the fitness of applicants for a licence and of existing licensees.⁹ We propose that this guidance is, where appropriate, turned into either FCA rules or FCA guidance.
- 7.43** We will consult on turning the following OFT guidance into FCA rules and guidance, as appropriate:
- Consumer Credit Licensing (January 2008) – general guidance for licensees and applicants on fitness and requirements.
 - Irresponsible Lending – OFT Guidance for creditors (updated February 2011).
 - Mental Capacity (September 2011).
 - Credit brokers and credit intermediaries (November 2011).
 - Debt Collection: Guidance for all businesses engaged in the recovery of consumer credit debts (July 2003, updated November 2012).
 - Debt Management (and credit repair services) guidance (March 2012) (see also Chapter 8).
 - Misleading or otherwise undesirable names guidance (April 2012).
 - Payment Protection Guidance (FSA and OFT Joint Guidance) – Annex 2: OFT Guidance (January 2013).
 - Second charge lending – OFT guidance for lenders and brokers (July 2009).
- 7.44** We intend to approach replicating the substance of the guidance so that firms that already comply with it are unlikely to need to change their behaviour.

⁹ i.e. guidance produced under Section 25A of the CCA

- 7.45 We expect to turn guidance into rules in cases where the current drafting reflects the OFT's intention that firms must follow the guidance *in all cases* (i.e. there is no discretion depending on the circumstances).
- 7.46 We will consult on detailed proposals in autumn 2013.

Other OFT guidance

- 7.47 The OFT also issues other guidance which gives its interpretation of firms' responsibilities under the CCA. We will consider which parts of this guidance would continue to be useful for firms and consider whether we should turn it into FCA guidance, such as:
- The post-contract information requirements (July 2008) – guidance on post-contract information requirements introduced by amendments made under the 2006 Act.
 - The guidance on Sections 77, 78 and 79 of the Consumer Credit Act 1974 (October 2010) – the duty to give information to debtors and the consequences of non-compliance on the enforceability of the agreement.

When will the rules apply?

- 7.48 We intend to consult on our draft detailed conduct rules and guidance in autumn 2013 and expect to publish the final rules and guidance in March 2014. The rules and guidance will come into force in April 2014. This is necessary because of the timing of the transition.
- 7.49 Firms that already comply with the CCA requirements and OFT guidance will only need to make minimal, if any, changes to their businesses. However, we want to give firms time to get to grips with the new structure and style of rules and guidance. So we propose a six-month period during which, if the firm is able to demonstrate that it has acted in accordance with old CCA requirements and OFT guidance, the FCA will not take action against it in relation to those corresponding new rules that are substantially the same. This will give firms time to make administrative changes, such as changing references in compliance manuals.

Financial promotions

- 7.50 Financial promotions are communications including advertisements which contain an invitation or inducement to a consumer to buy regulated services or products. Firms must ensure that advertisements are fair, clear and not misleading.
- 7.51 The Government is consulting on applying a similar framework for regulating advertisements for most consumer credit as the one that is applied to other FCA-regulated activities. This is referred to as the 'financial promotions regime'. The exceptions proposed by HMT are debt collection, debt administration, providing credit references and credit information services.
- 7.52 The Government proposes to replace the CCA advertisements regime with the application of the FSMA financial promotions restriction, breach of which is a criminal offence.¹⁰ We

¹⁰ Under section 137R FSMA.

propose to consult on detailed financial promotions rules which reflect our approach to other regulated activities. Our CBA work has identified this as an area that may have a significant additional cost for firms, because of the increased level of scrutiny of individual advertisements required by the financial promotions regime.

- 7.53** We will consult on the proposed rules in autumn 2013. As part of this consultation we may consider new rules where there is evidence of harm being caused to consumers. Our discussions with firms and consumer groups have highlighted concerns about advertisements for certain high-cost credit products, such as payday loans, advertisements by debt-management companies, cold calling and other unsolicited marketing activities. In some areas, we will not be able to make new rules because we cannot go beyond the requirements of the CCD.
- 7.54** We expect to propose detailed rules for financial promotions aimed at consumers and not to extend them to activities aimed solely at businesses.
- 7.55** When we consult on the proposed rules we will consider the appropriate time by which firms must comply.

Summary of our proposals

We propose to bring across broadly the same conduct standards into our regime from the current regime.

We propose that repealed conduct provisions of the CCA are broadly replicated in FCA rules and that OFT guidance is replicated in FCA rules and guidance.

For these FCA rules, we propose a six-month period during which, if the firm is able to demonstrate that it has acted in accordance with old CCA requirements and OFT guidance, the FCA will not take action against it in relation to those corresponding new rules that are substantially the same.

We will develop rules and guidance and implement a financial promotions regime with the same structure as other financial services products.

Q15: Do you agree with our proposed approach to financial promotions?

Section 3: Industry codes

What are industry codes?

- 7.56** The CCA regime is currently supplemented by a number of industry codes. These are published by a range of trade associations and apply to members of those associations. The aim of the codes is to establish best practice within a particular sector. Some codes are subject to independent monitoring processes, but the majority are more like membership rules, which are monitored by the particular trade association.

- 7.57 This section considers the future role of these codes and how they will interact with our conduct regime.

The role of the industry codes

- 7.58 Many of the industry codes form the basis for membership of trade associations, setting a common framework within which members of the trade association operate. They are also helpful in translating how regulatory requirements might be adopted in particular industry sectors.
- 7.59 We encourage trade associations to continue their work on codes, and are keen to establish relationships with code owners to help us understand the key issues for particular industries when dealing with their customers. The content of the codes will be a matter for the relevant trade association. We are only likely to be concerned about their content if the requirements of the code are lower than the conduct requirements of our regime.

Compliance and enforcement

- 7.60 In the current regime, where there has been limited scope for the OFT to supervise firms, the enforcement of compliance with industry codes by trade associations and independent boards has plugged an important gap. However, we will have dedicated supervisory resource for monitoring firms' compliance with our own regime and so are unlikely to place reliance on third parties to monitor firms' behaviour. During the interim permission period, when we are building our supervisory approach, we would like to explore with code owners how their activities could complement our own work.

Incorporating codes into FCA rules and guidance

- 7.61 Preliminary work shows that there are some requirements in codes that set standards beyond CCA or OFT guidance, which can provide additional protection for consumers and that we may want to consider incorporating into FCA rules and guidance.
- 7.62 We will consider further whether certain conduct standards in codes should be incorporated into the formal FCA conduct of business requirements as either a rule or guidance and bring them into force as soon as possible. We would have to satisfy ourselves that such requirements do not go beyond maximum harmonising provisions within relevant EU Directives.
- 7.63 We will consult on any recommendations in our autumn 2013 Consultation Paper. Incorporating code provisions into FCA rules and guidance could have cost benefit implications, as costs are likely to be incurred by anyone operating within the sector who has not signed up to the relevant code.

Summary of our proposals

We are considering whether to include certain code provisions in our conduct rules. If we decide to do so, we will consult on draft rules in autumn 2013.

Q16: Are there provisions within industry codes that you think should be formally incorporated into FCA rules and guidance?

8

Conduct standards: specific activities

When setting specific standards of conduct for firms carrying on specific credit activities, we are providing appropriate, and in some cases enhanced, protections for consumers.

In setting these standards we are taking account of the risks to consumers associated with particular credit activities and the need to ensure that any regulatory requirements imposed on firms are proportionate to those risks.

8.1 Chapter 7 sets out our proposed general approach to setting the standards that the FCA will require of all firms carrying on consumer credit activities. In this chapter we set out our proposed approach to applying standards and rules to firms carrying on specific credit activities, including:

- firms providing debt advice, including not-for-profit debt advice firms;
- firms that hold client assets;
- peer-to-peer lending platforms; and
- firms that outsource the tracing of debtors to third-party tracing agents.

Firms providing debt advice

8.2 For the provision of debt advice to be a regulated activity, the provider must be carrying on the activity of ‘debt counselling’. This involves giving advice to a borrower about the liquidation of a debt that is due under a consumer credit agreement, for example advising the borrower on steps they can take to free themselves from their obligations to the creditor in respect of such a debt.

8.3 Providing ‘generic’ debt advice does not involve carrying on the activity of debt counselling. This is because providing generic advice does not involve advising a borrower on the

liquidation of a debt that is due under a consumer credit agreement. An example of generic advice is ‘I recommend not borrowing more than you can afford’.

- 8.4 While we expect all regulated debt advice to be high quality, we propose to apply different rules to different types of advice, reflecting the different nature of the advice and associated risk.
- 8.5 Where advice is given to a borrower on the liquidation of a debt that is specific to the borrower, but the advice provider does not identify and/or recommend a particular ‘debt solution¹’ for the borrower to enter into, we propose that it should be sufficient for the advice provider to ensure that they observe the FCA’s high-level Principles for Businesses. For example, advising a borrower on their weekly household budget in order to better enable them to meet repayments of the money they owe under their credit agreement(s) as they fall due.
- 8.6 Principle 9 states that ‘a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement’. Principle 6 (treating customers fairly) and Principle 7 (communications with clients should be clear, fair and not misleading) are also particularly relevant to giving debt advice.
- 8.7 OFT guidance contains provisions similar to some of our high-level Principles for Businesses. For example, it refers to treating consumers fairly and to having regard to the best interests of the consumer when providing debt advice. So the implications (in terms of cost and compliance procedure) of observing our Principles should be limited for firms that are already observing the similar principles in the OFT guidance.
- 8.8 Where the advice provider *does* identify and/or recommend a particular debt solution for a borrower to enter into. For example, an adviser in a debt management business advising a borrower to enter into an individual voluntary arrangement (IVA). There may be particularly serious consequences for a borrower if the debt solution identified is inappropriate for them given their circumstances. So we propose that where firms advise borrowers to enter into particular debt solutions, this activity should be subject to comprehensive ‘conduct of business’ rules. We consider that these rules should incorporate appropriate parts of the OFT’s debt management guidance.²
- 8.9 Debt management businesses often identify and/or recommend particular debt solutions to borrowers. Indeed, they may carry on debt counselling together with the activity of debt adjusting³ and not only advise on the liquidation³ of the borrower’s debt, but also manage the borrower’s participation in a particular debt solution.
- 8.10 The Government’s proposals for the regulation of ‘not-for-profit’ debt advice firms carrying on debt counselling alone or together with debt adjusting and/or credit information services⁴ are set out in its consultation paper. It is proposing that such firms should meet

1 Examples of specific ‘debt solutions’ would be entering into an individual voluntary arrangement (IVA) or a debt arrangement scheme (DAS).

2 The debt management guidance covers marketing and advertising practices, what constitutes ‘appropriate advice’, transparency of fees and charges and pre-contract information.

3 ‘Debt adjusting’ involves negotiating with a creditor, on behalf of a borrower, terms for the discharge of a debt due under a consumer credit agreement.

4 ‘Credit information services’ involve advising a person how he can find out whether an agency holds information about his financial circumstances, including his credit rating and, if appropriate to do so, how he can arrange for any such information to be corrected (or doing so on the person’s behalf).

modified Threshold Conditions. We propose that both profit-seeking and not-for-profit providers⁵ of debt counselling services, alone or together with debt adjusting services, should be subject to the same rules, depending on the type of debt advice being provided.

- 8.11** So, for example, we consider that both profit-seeking firms and not-for-profit debt advice firms should be subject to comprehensive conduct of business rules where they are advising borrowers to enter into particular debt solutions. We believe that consumers should be able to expect appropriate debt advice and high standards of conduct from both profit-seeking and not-for-profit firms.

Table 8.1: Features of different types of regulated debt advice

Advice provided on liquidation of consumer credit debt, including on entering into a particular debt solution	Advice provided on liquidation of consumer credit debt
Debt advice likely to be provided as a main business activity.	Debt advice less likely to be provided as a main business activity.
Provider more likely to carry on debt adjusting in conjunction with debt counselling.	Provider less likely to carry on debt adjusting in conjunction with debt counselling.
Provider of debt advice identifies and/or recommends a particular debt solution to a borrower after assessing their financial circumstances and may manage the borrower's participation in the debt solution.	Provider of debt advice does not identify or recommend a particular debt solution to a borrower.

Firms holding clients' assets

- 8.12** Client assets are money or property held by a firm on behalf of a customer.
- 8.13** We have identified the following as consumer credit activities where a client's 'property' may be held by a firm:
- pawn broking – where the client asset (known as 'the pledge') is held by the firm as security for the loan; and
 - logbook lending (also known as Bills of Sale lending) – where a loan is secured against a borrower's car and the lender can, on default, take possession of the car.
- 8.14** We may propose new client asset guidance or rules for these activities. However, some of our concerns will be addressed by the FCA Principles for Businesses, in particular, Principle 10, and also clients' assets and systems and controls rules.
- 8.15** We consider debt management businesses to be the firms in the credit sector that pose the greatest risk to consumers from holding client 'money'. OFT guidance for debt management firms on holding client money states that firms should hold client monies in separate client accounts so that it is 'protected' if the firm fails. We propose to turn the relevant OFT guidance into FCA rules and/or guidance.⁶

⁵ A definition of a 'not-for-profit body' is to be added to the Glossary of the FCA's rules (see draft rules in Appendix 1).

⁶ We are also considering applying rules that create a statutory trust on client monies held by all firms.

- 8.16 However, we also want to provide extra protection for consumers. So we propose to strengthen our client assets regime for the largest debt management firms that hold the most client money. In the autumn we will consult on additional rules requiring debt management firms holding client money above a certain amount to take additional precautions around how they hold and monitor it. The additional requirements may include:
- additional record keeping;
 - regular reconciliations;
 - notifying banks and receiving acknowledgement from them that clients' money is held on trust; and
 - annual independent client money audits.
- 8.17 We would not expect well-run firms to have difficulty complying with these rules. We acknowledge that a two-tier approach based on firm size may lead to different outcomes for customers of different firms. However, our analysis shows that applying the same requirements to firms that only hold small amounts of client money may lead to the costs for these firms being disproportionate.

Peer-to-peer lending platforms

- 8.18 The Government is proposing that the activity of 'operating an electronic system in relation to lending' by peer-to-peer lending platforms should be made a bespoke regulated credit activity. The proposed new regulated activity covers the platform's arrangements with both consumer⁷ borrowers and lenders.
- 8.19 We consider that consumers borrowing or lending via peer-to-peer platforms should be provided with enhanced protections. We envisage the lending aspect of a peer-to-peer platform's activities being treated as an investment activity and that lenders providing the finance should be appropriately protected regardless of the status of the borrower (for example whether the borrower is a consumer, sole trader, partnership or company).
- 8.20 Among the rules that we are considering applying primarily to protect consumer borrowers are:
- a requirement for the platform to provide borrowers with adequate explanations of the key features of the credit agreement (including identifying the key risks) before the agreement is made;
 - a requirement for the platform to assess the creditworthiness of borrowers before the credit agreement is made;
 - rules relating to 'financial promotions'; and

⁷ The definition of 'consumer' is likely to differ for consumer borrowers and consumer lenders. For consumer borrowers the definition would follow that of an 'individual' in the CCA and would include individual consumers, small partnerships and certain unincorporated bodies, it would not include companies that borrow. However, the definition of 'consumer' would be flexible enough to allow for rules to be made to protect consumer lenders where the loans were to companies and other borrowers.

- a requirement to include in the standard credit agreement a right for the borrower to withdraw from the agreement, without giving any reason, by giving verbal or written notice, within 14 days of the agreement being made.

- 8.21 However, it is too early to give more detailed proposals about the protections to be applied to protect borrowers or lenders in particular. We intend to talk to firms in the sector and interested consumer groups during the next few months to understand their needs and concerns.
- 8.22 We expect the FCA to consult on the rules to be applied to both the lending and borrowing aspects in autumn 2013. The final rules would be made in early 2014 and we realise that this will give firms limited time to implement them. Consequently, we will consider allowing a transition period to give firms time to meet some or all of the new standards.

Third-party tracing agents

- 8.23 The Government is proposing that a third-party, to whom the activity of tracing borrowers that owe money under consumer credit agreements is outsourced by the lender or a debt collector, should be an exempt person in relation to the debt collection activity, so long as the third-party takes no other steps to collect debts.
- 8.24 As set out in our rules, the FSA holds outsourcing authorised firms responsible for the way in which outsourced activities are carried on.⁸ We propose that the FCA adopts a similar approach for the outsourcing to third-parties of the tracing of consumer credit borrowers.

'Outsourcing' is defined in the FSA Handbook glossary as 'an arrangement of any form between a firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the firm itself'.

The rules state that 'if a firm outsources critical or important operational functions or any relevant services and activities, it remains fully responsible for discharging all of its obligations under the regulatory system....'

- 8.25 Consequently, authorised firms that 'outsource' the tracing activity to a third-party tracing agent would be held responsible for the carrying on of that activity (see Chapter 3).⁹
- 8.26 We propose that 'conditions' that currently apply to outsourcing FSA-authorised firms should be applied to authorised firms that are outsourcing to third-parties the tracing of borrowers under credit agreements. These conditions¹⁰ include:
- the outsourcing must not result in senior personnel delegating their responsibility;
 - the relationship and obligations of the outsourcing firm towards its clients must not be altered;

8 SYSC 8.1 sets out the FSA's general outsourcing requirements: <http://fsahandbook.info/FSA/html/handbook/SYSC/8/1>.

9 If an appointed representative outsources the tracing activity to a third-party tracing agent, the appointed representative's principal would be held responsible for the carrying on of the activity.

10 See SYSC 8.1.6.

- the conditions the firm must comply with to be authorised must not be undermined; and
- none of the other conditions subject to which the firm's authorisation was granted are removed or modified.

8.27 We also propose that the outsourcing firm should be subject to FCA rules specifically governing its use of tracing agents. These rules will incorporate aspects of the OFT's debt collection guidance relevant to the tracing activity, adapted as appropriate to apply to the outsourcing firm.

Summary of our proposals

- Firms carrying on regulated debt counselling but not identifying or recommending a particular debt solution to borrowers should be covered by the FCA's high-level Principles for Businesses.
- Firms carrying on regulated debt counselling that identify or recommend a particular debt solution to borrowers should be subject to standards in rules or guidance reflecting the standards in the OFT's debt management guidance.
- Additional rules should be applied to the largest debt management businesses that hold the most client money.
- Consumers borrowing or lending via peer-to-peer platforms should be provided with enhanced protections.
- An authorised firm outsourcing the tracing of debtors to a third-party tracing agent should be subject to conditions based on existing FSA rules for outsourcing firms and rules based on relevant aspects of the OFT's debt collection guidance.

Q17: Do you agree with the different standards that we propose to apply to different types of debt advice?

Q18: Do you agree with our proposed approach to applying client asset rules to debt management firms?

Q19: Do you have any comments regarding our proposed approach to peer-to-peer platforms?

Q20: Do you agree with our proposed approach to authorised firms that outsource the tracing of debtors to third-party tracing agents?

9

Supervision and reporting

Supervision is an important aspect of how we will regulate consumer credit firms to ensure they continue to meet our standards. We propose that they will be required to report specific pieces of information to us, to help us supervise them and mitigate risks. We will receive information from a variety of sources and respond to specific events to minimise harm to consumers. We propose that consumer credit advertising will also be subject to our financial promotions regime.

- 9.1 This chapter describes our proposed approach to supervising consumer credit firms, which is different from the OFT's current practice in a number of ways. It also covers our proposals for a limited amount of 'regulatory reporting'.¹

The FCA's approach to supervision

- 9.2 All firms regulated by us will have to meet the standards set out in the relevant rules and give us information so we can monitor their business. Our supervisory approach for consumer credit firms will be consistent with the approach for all firms regulated by the FCA. However, during the interim permission regime, we propose to take a modified approach designed to smooth the process, especially for firms not previously regulated by the FSA.

Categorising firms

- 9.3 Firms will be categorised according to their potential impact on the FCA's objectives. The category in which we place a firm will determine the way we supervise it and the intensity of that supervision. Firms will be categorised for conduct and prudential purposes separately.
- 9.4 We are still finalising the method we will use to categorise consumer credit firms. However, it is likely to include factors such as the size of the firm, the number of retail customers and the perceived risk to consumers due to the firm's activities.

¹ Regulatory reporting – firms provide statistical data on their activities in a pre-determined format at regular intervals. It is then used to identify risks in individual firms and emerging themes in the sector and to inform supervisory strategies.

Fixed and flexible portfolio firms

- 9.5 We expect that firms with a very substantial number of retail customers – for example, large retail banks – will be referred to as ‘fixed portfolio’, which means that they will have a nominated supervisor.
- 9.6 We propose that smaller firms will be referred to as ‘flexible portfolio’, which means that they will be supervised by a team of sector specialists, and will not have a nominated supervisor. We expect that the vast majority of consumer credit firms will be in the ‘flexible portfolio’ category.
- 9.7 We propose to engage with firms, trade associations and consumer groups to understand more about the sector and build an open and transparent relationship.

Our ‘supervisory activities’ – how we will supervise you

- 9.8 Our supervisory approach will be driven by three activities. These are outlined below although a fuller description can be found in the *Journey to the FCA* document.² The activities are:
- **Firm Systematic Framework** – preventative work through structured conduct assessments.
 - **Event-driven work** – dealing quickly and decisively with problems that are emerging or have happened and securing compensation for consumers or finding other ways to correct the problem where necessary. This will be largely based on information gathered from our supervisory work with firms.
 - **Issues and product supervision** – fast, intensive campaigns on a market sector or products/services that are putting or may put customers at risk.
- 9.9 The nature and extent of our supervisory relationship with a firm will depend on which category they are in and our assessment of the potential risk posed by the firm to consumers and other market participants. We propose to apply each of the supervisory activities to all firms, but with varying degrees of intensity, depending on the levels of risk a firm poses and the credit activities it carries out.
- 9.10 For most firms we propose to use a combination of supervisory interaction (focusing on specific regulatory issues) and the analysis of firm-specific and industry data to identify trends and irregularities in the market. This would help us to determine the issues, product and firm-specific work we should do. By issues and product work, we mean operating sector-wide projects to address risks across a wide range of firms, or a particular segment in the market or a particular product or service.

Firm Systematic Framework (FSF)

- 9.11 This would be firm-specific, proactive supervisory engagement with firms, where we propose to undertake a risk-based assessment of their conduct and establish whether the interests of customers and market integrity are at the heart of how the firm is run.

² http://www.fsa.gov.uk/about/what/reg_reform/fca

9.12 The FSF would do this by using a common framework, which would be applied with varying intensity depending on the risk posed by the firm and its impact on the market. The common features of the FSF for larger firms would include:

- **Business model and strategy analysis** to analyse how sustainable the business would be in terms of conduct and where future risks might lie, linking to the business model Threshold Condition check we will carry out at the authorisation stage.
- **Assessing how the firm embeds fair treatment of customers and ensures market integrity** in the way it conducts its business. The assessment has four modules:
 - **governance and culture** – to assess how effectively a firm identifies, manages and reduces conduct risks;
 - **product design** – to determine whether a firm’s products and services meet customer needs and are targeted accordingly;
 - **sales or transaction process** – to assess the firm’s systems and controls; and
 - **post sales/services and transaction handling** – to assess how effectively a firm ensures its customers are treated fairly after the point of sale, service or transaction, including complaints handling.
- **Deciding what actions are required by the firm** to address issues we have identified;
- **Communicating with the firm** to set out the findings of the assessment and the required actions;
- **A regulatory cycle**, which will typically be a two-to four-yearly FSF risk assessment. The period depends on how the firm is categorised.

The FSF for smaller firms

9.13 For smaller firms, we propose to carry out the FSF against the same areas as for larger firms, although the intensity of our work will be proportionate to the size and type of firm and the perceived risk in the activities the firm carries out.

9.14 Firms with limited permission are subject to different Threshold Conditions than higher-risk firms. We propose to carry out a proportionate FSF, taking into account the different requirements that apply (for example, limited permission firms will not be subject to business model and strategy analysis).

9.15 We propose that there will be specific regulatory engagement with smaller firms once every four years. This could range from using interactive media and workshops providing key regulatory information across all firms, to an online assessment, a direct assessment of firms through a supervisor-led interview, or a combination of these. The exact interaction will be adapted and vary in intensity depending on our assessment of the risks such firms pose to our objectives.

Event-driven work

- 9.16 We propose to carry out this firm-specific work in response to information that indicates risks in firms and potential harm to consumers.
- 9.17 The information can be broadly split into two categories: information received directly from firms as part of the reporting regime; and information received from other sources external to the FCA, such as consumer complaints, whistleblowing and information provided by trade bodies. We will also work closely with LATSS and DETINI as a source of information in ongoing event-driven supervision, and to ensure that the remaining requirements of the CCA are appropriately enforced.
- 9.18 Issues identified will be prioritised, concentrating on where there is an increased risk to consumers or where consumers have experienced some loss and we need to stop the situation from worsening.
- 9.19 Our interaction with firms will range from a desk-based analysis, to visits to firms' premises, depending on the nature and severity of the risk being investigated. We propose that this approach will allow supervisors to intervene swiftly, taking a proportionate approach.
- 9.20 Firms may be required to take action to address the issues we identify and we may undertake supervisory work in line with our powers to achieve a particular outcome.³

Issues and products

- 9.21 Issues and product work consists of sector-wide projects to address risks across a wide range of firms, or a particular segment in the market or a particular product or service.
- 9.22 We propose to use a sector risk-assessment to complement our firm-specific work. Together they will identify risks whether there are any cross-firm issues, firm specific issues or product issues.
- 9.23 We will use a range of data, information and intelligence from firms, consumers and trade bodies, for example, to help us identify the most significant risks and to prioritise our activity in this area.
- 9.24 We propose that a specialist sector team will carry out these assessments, making good use of external and market information. We will consider the full range of options before deciding what to do. We could ask a firm to take action to fix a problem, use our enforcement powers to take a more punitive approach with firms or, where the payment of redress to consumers is appropriate, make new rules or issue guidance that firms must observe.

³ Supervisory work includes but is not limited to: the appointment of a skilled person to undertake an independent review of aspects of a firm or its activities; varying the regulated permissions of a firm to restrict its activity or stop it from undertaking regulated activities; and issuing a formal private warning to a firm on its conduct/behaviour.

Financial promotions and consumer credit advertising

- 9.25** We propose to align the supervision of consumer credit advertising with the supervision of our existing financial promotions regime. This means we will carry out a variety of supervisory activities. In particular, we intend to:
- for higher-risk activities, proactively monitor advertisements across all media types to assess whether they comply with the relevant consumer credit rules and take action where cases are in breach;
 - carry out thematic work that focuses on either a product, risk, media type or section of the rules (thematic work, excluding initial researching, will usually be determined by the level of risk posed); and
 - review complaints received through our financial promotions hotline, or intelligence gathered through supervisory referrals and, if they are in breach and within our risk appetite, we will decide if we should take action.
- 9.26** As is the case for existing regulated firms, we will adopt a risk-based approach to casework. This means we will proceed with cases that pose the greatest risk to consumers and the FCA's objectives.
- 9.27** As for other supervisory functions, we will have all the disciplinary tools at our disposal for those firms who breach the financial promotion rules. This will include a power to ban financial promotions.

Unfair terms in consumer contracts

- 9.28** The FCA will have powers under the Unfair Terms in Consumer Contracts Regulations 1999 to challenge unfair terms in standard form consumer contracts.
- 9.29** We propose to apply a risk-based and proportionate approach to decide whether to pursue a particular matter. This considers factors such as the number of consumers that might be affected by an unfair term, the risk of potential or actual harm to consumers and whether it would be a proportionate use of our resources.
- 9.30** If we decide to take action, we have the power to accept a firm's assurance that it will no longer use unfair terms and we can apply for injunctions if a firm will not give us an assurance or breaches one it has given.
- 9.31** We may also act on our own initiative to look beyond resolving an individual referral, and may consider a thematic approach. This may be in the form of a review of a firm's systems and controls around drafting and updating contracts, or it may involve a review of a range of firms' contracts for a particular product.

Prudential supervision

- 9.32 Details on our approach to prudential supervision can be found in Chapter 6 and in the *Journey to the FCA* document.
- 9.33 Some firms with a consumer credit licence will already be subject to prudential supervision by the FSA/PRA. The PRA supervises banks, building societies, credit unions, insurers and friendly societies and designated investment firms. The PRA approach document⁴ sets out how the PRA will supervise these firms.

The FCA approach to regulatory reporting

- 9.34 The majority of firms that we regulate are subject to reporting requirements set out in the supervision module of the Handbook.⁵ The information firms report to us gives us the data we use to monitor firms' prudential position and conduct of business.
- 9.35 We use this information for our supervisory activities. The consumer credit reporting regime will focus on the most relevant information that will help the FCA to maintain a picture of the overall size and breakdown of the consumer credit market, both in terms of turnover and number of consumers. This will enable the FCA to focus its resources on the sectors and issues that are of greatest significance.
- 9.36 For the consumer credit lending sector, we are also considering collecting transactional information from firms reporting on individual product sales or transactions. We believe that by collecting information about the particular features of the loan product and the customer profile, we will be able to build a valuable understanding of lending trends, which should provide us with a better understanding of customer affordability and vulnerability issues in this sector of the market against the different categories of lending. We will also use this data to understand the relationship between brokers and lenders in the distribution of loan products, identifying where customers may have been treated unfairly when approaching brokers to source a loan. Examples of transactional information could include: loan amount, term, purposes of the loan, borrower's age, postcode and income.
- 9.37 We are particularly planning to use regulatory data to help us to mitigate the risks posed to customers by consumer credit firms. These include the risk of high losses relative to wealth, the risk of widespread small losses and the inherent risk of increasing harm to a consumer if they cannot meet their obligations. There is also the potential for consumer harm as a result of firms in financial difficulties.
- 9.38 We use various pieces of reported information, such as turnover and amount of new loans to calculate periodic fees.
- 9.39 While it is necessary for the FCA to collect information, it will be proportionate to the activities undertaken and size of the firm, and we will try to avoid causing undue disruption or burden on the industry.

⁴ www.bankofengland.co.uk/publications/Documents/other/pr/bankingappr1210.pdf

⁵ SUP 16.

9.40 Estimated costs associated with regulatory reporting are included in our cost benefit analysis. See Annex 3.

Summary of our proposals

- For firms carrying on consumer credit activities, we propose to collect some key financial information that will enable the FCA to establish the financial size and health of firms. Existing FSA firms already provide this sort of information through the current reporting regime.
- For all firms carrying on consumer credit activities, we will need some key measures of those activities, such as turnover, transaction information and complaints information.
- For firms carrying on lending activities, we are likely to need some transactional information about loans, such as the total value of the loan book, or the amount of customers in default.
- For firms carrying on debt management activities, we expect the FCA to collect a small amount of information to demonstrate a firm's compliance with capital adequacy and client assets rules.
- Firms with a limited permission would have a reduced reporting requirement.

Q21: Do you have any comments regarding our proposed approach to supervision and regulatory reporting?

10

Enforcement

Enforcement action is designed to provide a credible deterrent to firms to prevent them from committing wrongdoing, while taking swift, strong action against those that cause the most harm. Our enforcement powers under FSMA are significantly greater than the OFT's powers under the CCA.

We will work alongside LATSS and DETINI, among other bodies, to uncover and stop unauthorised business, such as loan sharking. We will also seek to ensure that where a firm has committed wrongdoing, consumers are adequately compensated.

What is enforcement and why is it important?

- 10.1** We want our enforcement action to stop firms and individuals from harming consumers' interests or damaging the integrity of the consumer credit market. Our enforcement teams and supervisory staff can, for example, detect and penalise businesses that trade without authorisation, or investigate possible wrongdoing by authorised firms.
- 10.2** The FCA will have a wide range of enforcement tools available for consumer credit activities. These enforcement powers are set out in FSMA. Having a range of tools available means we can be flexible when responding to different situations.¹
- 10.3** Enforcement action will play a key role in investigating potential problems at an earlier stage, and taking steps to avert them. We will, however, take a proportionate approach, prioritising those firms that cause (or could cause) the most serious harm to the consumer credit market and consumers.

Our enforcement powers

- 10.4** We will have investigatory powers allowing us to:
- make people answer questions and provide documents or information, including banking records; and
 - apply for warrants to enter and search premises.

¹ The Government's consultation document www.hm-treasury.gov.uk/home.htm explains the changes made to FSMA that will allow us to take enforcement action in relation to consumer credit activities.

- 10.5 We will also have the power to bring civil, criminal and disciplinary proceedings. These powers will enable us to:
- withdraw authorisations and approvals;
 - stop individuals from working in financial services;
 - stop an individual from carrying out specific regulated activities;
 - suspend a firm for up to 12 months from carrying out specific regulated activities;
 - suspend an individual for up to two years from carrying out specific regulated activities;
 - publicly censure firms and approved individuals;
 - impose substantial financial penalties;
 - seek injunctions;
 - apply to court to freeze a firm's or individual's assets;
 - seek restitution orders; and
 - prosecute firms and individuals who undertake regulated activities without authorisation.
- 10.6 We will get our enforcement powers for consumer credit business on 1 April 2014. These powers are significantly greater than those currently available to the OFT, which can, for example, only impose civil penalties where a firm has failed to comply with certain requirements of the CCA.
- 10.7 We will liaise closely with other bodies when carrying out enforcement action, such as LATSS and the Illegal Money Lending Teams (IMLT's), who will retain powers to investigate and prosecute consumer credit offences.
- 10.8 A general guide to our approach to enforcement and our policy for imposing penalties can be found in our *Enforcement Guide*² and our *Decision Procedure and Penalties Manual*.³ These documents will apply equally to the enforcement of consumer credit activities and will be reviewed with this in mind in due course.

When can we use our enforcement powers?

Unauthorised business

- 10.9 We will investigate those suspected of undertaking regulated activities without the necessary permission. FSMA has been amended⁴ so that an authorised person who enters into,

² <http://fsahandbook.info/FSA/html/handbook/EG>

³ <http://fsahandbook.info/FSA/html/handbook/DEPP>

⁴ Subject to provision required in secondary legislation.

administers, or exercises rights under credit agreements (or is able to do so) or collects debts outside of their permission commits an offence.⁵

- 10.10 We will investigate persons without the necessary authorisation or with no authorisation at all and, where appropriate, we will prosecute them. They may alternatively, or additionally, be subject to civil injunction proceedings.
- 10.11 Our work will run in parallel with the important work of the LATSS and the IMLTs, who will continue to combat loan sharks. We will ensure our activities are coordinated and we will seek to agree a memorandum of understanding to set out how we will work together.
- 10.12 Firms who have been refused permission by the FCA or the PRA will be prevented from continuing their activities either by the IMLT's, or through the FCA enforcement powers.

Use of disciplinary toolkit for CCA conduct provisions

- 10.13 HMT's draft secondary legislation provides for the FSMA disciplinary toolkit to apply to requirements in the CCA and its secondary legislation. Therefore breach of such a requirement, for example, the regulations⁶ which set out the form and content of credit agreements which will remain in place, could after 1 April 2014 give rise to action using the FSMA disciplinary toolkit.
- 10.14 The FCA would need to issue a statement of policy on how it would use the toolkit in relation to these requirements. The statement would have to include the FCA's policy on the imposition of, and the amount of financial penalties for breach of these requirements and the length of time for which suspensions and restrictions are to have effect. In exercising one of the powers in the disciplinary toolkit the FCA would have to have regard to the statement of policy.

Offences committed under the Consumer Credit Act 1974 (CCA)

- 10.15 After 1 April 2014, the Government proposes that a small number of the criminal offences set out in the CCA will continue to apply to credit firms. The Government proposes that FSMA enforcement powers are applied to specified requirements of the CCA so that disciplinary powers under FSMA (such as public censures, financial penalties and suspension of permissions) could be applied to such an offence under the CCA. Where the FCA uses such powers, the firm cannot also be convicted of the relevant CCA offence for the same act or omission.
- 10.16 The FCA will engage with the Government, LATSS and DETINI regarding the practical application of this provision.

⁵ Note that, for other activities regulated under FSMA, an authorised person who trades outside of its permission breaches a requirement of that law, but does not commit an offence. The position in relation to the relevant consumer credit activities will therefore differ. See section 23A(2) FSMA.

⁶ Consumer Credit (Agreements) Regulations 2010, S.I. 2010/1014.

Enforcing breaches of the Money Laundering Regulations 2007

- 10.17** Where a consumer credit firm is subject to the Money Laundering Regulations 2007⁷, and the responsibility for a firm's compliance with these regulations moves to the FCA, we will be able to take investigatory and enforcement action.
- 10.18** Our powers will include the ability to:
- require information by serving a written notice on a firm or any person connected to it;
 - require individuals working at or connected to a firm to attend an interview;
 - enter and inspect premises without a warrant where there is reasonable cause; and
 - apply to the court for a search warrant, allowing a police constable to enter and search premises and to take possession of documents.
- 10.19** The Money Laundering Regulations also allow us to impose penalties on firms we supervise that are in breach of requirements, and to prosecute a firm that is in breach of the regulations, or its officers. A conviction may result in imprisonment for up to two years, a fine, or both.⁸
- 10.20** Once a firm is authorised by the FCA, we will be able to take action for breaches of the Money Laundering Regulations. We will consider all factors when deciding whether to bring enforcement action using our FSMA or Money Laundering Regulations powers.

What action can we take against misconduct from before 1 April 2014?

- 10.21** While we will not be able to apply our new sanctioning powers retrospectively, we expect to be able to use our investigatory powers to look at past behaviour and apply the sanctions that were in force at the time.
- 10.22** For example, in relation to a credit agreement already in existence on 1 April 2014, we expect to be able to apply our enforcement powers under FSMA to specified CCA requirements in relation to acts, omissions or events on or after that date. We do not expect to be able to impose fines for misconduct that occurred before 1 April 2014, other than where these could have been imposed under the CCA. However, we would be able to vary or cancel a firm's permission and prevent it from trading, taking into account conduct which was unlawful.
- 10.23** On 1 April 2014, we expect the OFT will have open investigations and proceedings underway. We expect that responsibility for these cases will be transferred to the FCA. This will allow us to continue investigations and enforcement action begun by the OFT.

⁷ Please see Chapter 12 for details on what firms will be subject to the Money Laundering Regulations.

⁸ Paragraph 12.2 of the FSA Enforcement Guide (EG).

Next steps

- 10.24** We will develop an enforcement strategy that complements our approach to authorisation and supervision. We will also review our *Enforcement Guide* and our *Decision Procedure and Penalties Manual*. We are discussing with appropriate bodies how best to work together before and after April 2014 and we expect to agree memoranda of understanding to manage relations with other bodies.

Summary of our proposals

- We will get our enforcement powers on 1 April 2014, which will be greater than current OFT powers, and enable a flexible approach to dealing with different situations.
- We propose to develop our consumer credit enforcement strategy so that it complements our approach to authorisation and supervision.
- We will develop our approach to enforcing the criminal sanctions that will remain in the CCA.

Q22: Do you have any comments regarding our proposed approach to enforcement?

11

Complaints and redress

We propose that we will retain the right for consumers to complain to the FOS if they are unhappy with the way that their complaint has been handled by a consumer credit firm. We propose that we will also require firms to submit information on the number of complaints that they receive to the FCA.

11.1 In this chapter we discuss our proposals on:

- handling complaints from consumers;
- access to the Financial Ombudsman Service (FOS), including for complaints against not-for-profit bodies providing debt advice;
- access to the Financial Services Compensation Scheme (FSCS); and
- complaints against the FCA and the PRA.

Handling complaints from consumers

11.2 Currently, firms licensed by the OFT to carry on consumer credit activities must comply with a number of requirements to ensure they treat their customers fairly when handling complaints:

- Where a firm is authorised by the FSA and in the scope of the FOS's Compulsory Jurisdiction, the FSA makes the rules.
- Where a firm is licensed by the OFT but not FSA authorised, and is in the scope of the FOS's Consumer Credit Jurisdiction, the FOS makes the rules.
- The FOS also makes the rules for firms that are in the scope of the FOS's Voluntary Jurisdiction.

Table 11.1 gives an overview of what these jurisdictions cover (pre 1 April 2014)

	Compulsory Jurisdiction	Consumer Credit Jurisdiction	Voluntary Jurisdiction
Type of firm	Firms authorised by FSA	Firms licensed by OFT but not authorised by FSA	Firms that choose to join it
Type of activity	Activities regulated by FSA and some other activities e.g. consumer credit activities	Consumer credit activities	Activities not covered by the Compulsory Jurisdiction or Consumer Credit Jurisdiction
Territorial scope	Activities carried on from an establishment in the UK	Activities carried on from an establishment in the UK	Activities carried on from an establishment in the UK or elsewhere in the EEA

- 11.3** The FOS is the single dispute resolution scheme set up by FSMA. It provides consumers with a free independent service for resolving disputes between consumers and businesses quickly and informally.
- 11.4** Most of the requirements relating to complaints handling apply equally to firms authorised by the FSA that carry on consumer credit activities and are in the scope of the Compulsory Jurisdiction, and firms that are licensed only by the OFT and are in the scope of the Consumer Credit Jurisdiction. The transfer of consumer credit regulation to the FCA will make no difference to the standards that firms should meet.
- 11.5** We expect that analysing complaints will be an important part of the FCA's approach to supervision. Currently, FSA-authorised firms must comply with requirements for recording and reporting complaints and in some cases must also publish information about complaints.
- 11.6** These requirements mean that we have access to information about the complaints firms receive, helping us to supervise how firms are carrying out their business. Firms that have received 500 or more complaints in six months are required to publish a breakdown of these complaints. We believe that publishing complaints data increases senior management focus on complaints and encourages improvements in complaints handling.
- 11.7** In line with our reduced regulatory reporting requirements for consumer credit firms, we propose to require firms carrying on consumer credit activities that are not currently authorised by the FSA to report and, where appropriate, publish a relatively small amount of complaints information.¹ For the purposes of the cost benefit analysis we have considered the impact of requiring firms that have received 500 or more complaints in a year to publish a breakdown of these complaints.²

¹ See Chapter 9.

² This is purely illustrative. It is not our intention to have more onerous requirements for consumer credit firms than other FSMA regulated firms.

Access to the Financial Ombudsman Service (FOS)

- 11.8** Customers of consumer credit firms who are unhappy with the way their complaint has been handled have the right to complain to the FOS. They must be eligible to complain to the FOS and must make their complaint in the time period set out in our rules or the FOS rules.
- 11.9** When regulation of consumer credit is transferred from the OFT to the FCA, firms that are currently licensed only by the OFT that want to remain in the consumer credit market will have to become authorised by the FCA (see Chapter 3). So these firms will then be in scope of the FOS's Compulsory Jurisdiction and their customers will still be able to complain to the FOS.
- 11.10** The Government will abolish the Consumer Credit Jurisdiction regime for new complaints after the transfer. However, complaints relating to the acts or omissions of firms that were licensed by the OFT, but not authorised by the FSA, that took place before the transfer of consumer credit regulation to the FCA will continue to be dealt with under the rules in the Consumer Credit Jurisdiction. Firms that decide to leave the consumer credit market will remain in the scope of the FOS's jurisdiction for complaints about their activities while they were licensed by the OFT.
- 11.11** Customers that are small businesses or 'micro-enterprises'³ can complain to the FOS under the Compulsory Jurisdiction and the Consumer Credit Jurisdiction. However, under the Consumer Credit Jurisdiction, there are exclusions. The following types of micro-enterprises are not eligible to complain to the FOS:
- a body corporate;
 - a partnership consisting of more than three persons;
 - a partnership, all of whose members are bodies corporate; or
 - an unincorporated body that consists entirely of bodies corporate.
- 11.12** We propose that, after the transfer, all micro-enterprises would be eligible to complain to the FOS.

Complaints against not-for-profit bodies providing debt advice

- 11.13** Firms or individuals that are holders of *individual* licences, including the non-commercial debt advice categories (see Chapter 3), are currently in the scope of FOS, but those providing non-commercial debt advice under *group* consumer credit licences are not.
- 11.14** The Government proposes that not-for-profit bodies providing debt advice will fall within the limited permission regime. Generally firms authorised by the FSA are subject to the FOS Compulsory Jurisdiction. Therefore, not-for-profit bodies providing debt advice would be subject to the Compulsory Jurisdiction, unless the FCA decides it does not apply to them.
- 11.15** Bringing these providers into the Compulsory Jurisdiction could increase consumer confidence, enhance consumer protection and access to redress. However, it also exposes

³ A micro-enterprise is an enterprise that employs fewer than ten people and has a turnover or annual balance sheet total that does not exceed £2m.

them to potential additional cost and liability. The level of risk will depend to some degree on the size, nature and resources of individual debt advice providers, but it is our understanding that this could have an impact on the ability of some of them to continue to provide free debt advice to consumers.

- 11.16** Given the different nature and circumstances of the various not-for-profit bodies providing debt advice and the differing degrees of risk they would face if they were subject to FOS jurisdiction, we propose that the Compulsory Jurisdiction should *not* apply to them. As an alternative, we propose that they should be able to ‘opt in’ to the FOS Voluntary Jurisdiction if they choose to do so. We will work with the FOS to develop this proposal.
- 11.17** Chapter 13 deals with our proposals in relation to FOS fees.

Access to the Financial Services Compensation Scheme (FSCS)

- 11.18** The FSCS is the UK’s statutory compensation scheme of last resort for customers of authorised financial services firms. It can pay compensation to eligible customers if a firm is unable, or likely to be unable, to pay claims against it. The FSCS is funded by levies made on financial services firms. The FSA (or, from 1 April 2013, the PRA and the FCA) makes the rules for the FSCS on what protection it can provide and how much compensation it can pay.
- 11.19** FSCS does not cover all regulated activities. It depends on the risks to consumers from particular financial products and services when a firm fails and cannot repay money it owes customers or cannot meet claims against it, for example for compensation for bad advice.
- 11.20** As we do not currently regulate consumer credit activities, there is no FSCS cover. We have considered whether the FSCS should cover some consumer credit activities that we think are higher-risk for consumers.
- 11.21** We believe that the risks to consumers fall into two broad categories:
- loss of client money held by a firm that carries out debt counselling and debt adjusting when operating a debt management business; and
 - financial loss from other causes, such as poor advice, particularly in the context of debt management businesses that are the primary providers of debt advice in the consumer credit market.
- 11.22** Some consumers are particularly vulnerable – especially those experiencing problems with debt – and these consumers are the most likely to use the services of a debt management firm. We believe that the strongest argument for introducing FSCS protection is in the debt management sector, where client money is at risk and companies may give unsuitable debt advice.
- 11.23** However, we currently only have limited information on which to assess the risks to consumers and to ensure that the cost of any FSCS compensation can be met by authorised firms. Initially we would expect this to be by other consumer credit firms. We would need to be sure that access to the FSCS was justified to protect consumers, taking into account the other protection measures if a firm fails, in particular, our rules on stricter client asset

rules for larger debt management firms and a minimum capital requirement. These measures will improve the chances that some money will be returned to customers.

- 11.24** We propose that there should continue to be no FSCS cover for consumer credit activities after the transfer to the FCA. However, we will keep this under review, taking into account responses to this consultation.

Complaints against the FCA and the PRA

- 11.25** The existing FSA complaints scheme is set out in the Complaints Against the FSA section of the FSA Handbook. The Financial Services Act 2012 requires the FCA, the PRA and the Bank of England to establish arrangements to investigate complaints made against them.
- 11.26** In November 2012, the FSA and the Bank of England jointly published a Consultation Paper on the proposed arrangements for handling complaints after the FSA splits into the FCA and PRA.⁴ The proposals adopted a very similar approach to the current FSA complaints scheme. We intend that the proposed arrangements should apply to any complaints relating to the FCA regarding consumer credit.

Summary of our proposals

- We propose that firms carrying on consumer credit activities that are not currently authorised by the FSA should record, report and where appropriate publish complaints information to the FCA.
- We propose that all micro-enterprises should be eligible to complain to the FOS about consumer credit.
- We will work with the FOS to develop the proposal that not-for-profit bodies providing debt advice should not be subject to the FOS Compulsory Jurisdiction but should have the option to 'opt in' to the Voluntary Jurisdiction.
- We do not propose to extend FSCS cover to consumer credit activities, but we will keep this under review.

Q23: Do you have any comments regarding our proposed approach to complaints and redress?

⁴ Available on our website: www.fsa.gov.uk/library/policy/cp/2012/12-30.shtml

12

Preventing financial crime

We propose to require all firms to actively take measures to prevent themselves and their customers from being exploited by criminals. We will also require firms subject to the Money Laundering Regulations 2007 to take further measures, including appointing a Money Laundering Reporting Officer.

The FCA's approach to financial crime

- 12.1** We propose that consumer credit businesses would, like all firms regulated by the FCA, be required to take measures to prevent themselves from being exploited by criminals such as fraudsters and money launderers.¹
- 12.2** A requirement to actively take steps of this kind will be new to the consumer credit industry; the OFT does not currently impose a similarly wide requirement but it can, for example, prosecute or impose civil penalties under the Money Laundering Regulations 2007.
- 12.3** We are not just interested in how businesses protect themselves from losing money – we will also be able to take action where a firm's actions expose customers or third-parties to the risk of crime (for example, if a firm loses an unencrypted disk containing sensitive customer data).
- 12.4** Some examples of types of financial crime risk we can look at are:
- How businesses protect themselves and their customers from losing money to fraudsters.
 - Many, but not all, consumer credit businesses are subject to the Money Laundering Regulations 2007.² We will ensure they comply: see the section on money laundering below.
 - The measures consumer credit firms take to ensure sensitive customer data does not fall into the wrong hands.
 - The steps businesses take to ensure they do not make funds available to people and organisations who have had their assets frozen by the Government.

¹ This requirement is set out in the Systems and Controls chapter of the Handbook. See SYSC 3.2.6 and SYSC 6.1.1.

² See Regulation 3(1) of the 2007 Regulations.

- How businesses, for example, tackle the risk that a member of staff might pay bribes to secure deals.
- 12.5** We will focus on gauging the adequacy of the policies and procedures firms have in place. We can take action against a firm with weak systems and controls, even if no crime took place. Our supervisory staff will consider these risks as part of their wider supervisory work. The FCA may also perform thematic work focusing on a particular financial crime risk, which would involve probing practices at a range of businesses, including consumer credit firms.
- 12.6** We will share information with a range of organisations (such as LATSS, DETINI, police forces, the Serious Organised Crime Agency and other regulators) to help us tackle these threats. This will happen when businesses apply to be regulated by us and as we supervise them afterwards. In addition, our whistleblowing service³ is available to receive disclosures about any kind of misconduct in the consumer credit industry.
- 12.7** Where our work leads us to have suspicion or knowledge of money laundering, we will report this to the Serious Organised Crime Agency.

Firms that are subject to the Money Laundering Regulations 2007

- 12.8** Firms that are consumer credit businesses (but are not regulated for non-credit activities by the FSA before 1 April 2014) are ‘consumer credit financial institutions’ and are subject to the requirements of the Money Laundering Regulations 2007.⁴ It is expected that the FCA will be responsible for ensuring these businesses comply with the regulations from 1 April 2014.
- 12.9** The Money Laundering Regulations require that these businesses must, for example, actively check each customer’s identity, and have internal procedures so staff can escalate suspicions about money laundering.
- 12.10** We propose that if a firm authorised by the FCA or PRA is subject to the requirements of the Money Laundering Regulations, our Handbook⁵ will also require that firm, for example, to:
- appoint a Money Laundering Reporting Officer (MLRO⁶) (unless the firm is a sole-trader with no employees) whom we expect to be located in the UK; and
 - give responsibility for anti-money laundering systems and controls to a director or senior manager.

³ Our whistleblowing service can be contacted on 020 7066 9200 or whistle@fsa.gov.uk

⁴ The formal definition of ‘consumer credit financial institution’ is set out in Regulation 22 of the Money Laundering Regulations 2007. See: www.legislation.gov.uk/ukksi/2007/2157/contents/made

⁵ Specifically under the Systems and Controls chapter: see SYSC 6.3.9.

⁶ The MLRO is responsible for overseeing compliance with our rules on systems and controls against money laundering, and to act as the focal point for all activity relating to anti-money laundering. The MLRO will often be the officer nominated to report suspicions or knowledge of money laundering to the Serious Organised Crime Agency. Firms must ensure the MLRO has a level of authority and independence within the firm and access to resources and information sufficient to enable him to carry out that responsibility.

- 12.11 These requirements are new to firms that the OFT supervises under the Money Laundering Regulations. For example, they do not currently need to appoint a MLRO with such broad responsibilities and subject to FSMA enforcement.
- 12.12 To express our proposals in terms of how we intend to amend rules in our Handbook of Rules and Guidance, we propose to apply all the existing rules in the Systems and Controls chapter (SYSC) that relate to financial crime to consumer credit firms, with the following exceptions. Firstly, consumer credit firms that are not subject to the Money Laundering Regulations will have the following rules disapplied:
- 6.3.1R and 6.3.3R requiring policies and procedures to deal with money laundering risks, and for these to be assessed regularly;
 - 6.3.8R requiring responsibility for handling the risks posed by money launderers to be allocated to a senior manager;
 - 6.3.9R (requiring the appointment of a MLRO); and
- 12.13 Secondly, limited authorisation consumer credit firms will have SYSC rules 6.3.8R and 6.3.9R disapplied.
- 12.14 This means that consumer credit firms which are not subject to the Money Laundering Regulations will, among other things, not need to appoint a MLRO. Similarly, neither will limited authorisation consumer credit firms, even where these businesses are subject to the Money Laundering Regulations. However, all businesses subject to the requirements of the Money Laundering Regulations are required to appoint a nominated officer under the Proceeds of Crime Act who is able to liaise with the authorities on matters relating to money laundering.

Next steps

- 12.15 We will build relationships with bodies such as LATSS, which will help us and them identify and tackle financial crime in consumer credit businesses.
- 12.16 We are considering how best to give guidance to the industry on the steps they can take to combat financial crime. We currently set out guidance aimed at authorised firms in *Financial crime: a guide to firms*.⁷ The OFT has also published guidance on how firms subject to the Money Laundering Regulations 2007 can meet their obligations.⁸ Another important source of guidance on anti-money laundering matters is the Joint Money Laundering Steering Group.⁹ We will set out more detailed proposals on how to provide guidance to consumer credit firms in due course.

⁷ <http://fsahandbook.info/FSA/html/handbook/FC/link/PDF>

⁸ www.of.gov.uk/OFTwork/aml/money-laundering/jsessionid=1D845A42002A246AD4FF7996FFE88616

⁹ www.jmlsg.org.uk/

Summary of our proposals

- Consumer credit businesses must take measures to prevent themselves, and their customers, from becoming victims of financial crime.
- We can take action where a firm's actions expose customers to a risk of financial crime, even where no crime has taken place.
- We will share information with relevant parties to help us tackle the threat of financial crime.

Q24: Do you have any comments on our proposed approach to tackling financial crime?

13

Fees

Introduction

13.1 This chapter sets out:

- background on how the FCA's consumer credit regime will be funded;
- our proposals for consultation on fees for interim permissions; and
- our high-level approach to authorisation and periodic fees for firms wishing to carry on consumer credit activities, and to the FOS general levy.

How the FCA is funded

13.2 Like the FSA and the OFT Consumer Credit Group, the FCA is not funded by the taxpayer, and must recover all the costs incurred to run it from the firms that it regulates. The law requires us to recover the necessary funds through:

- fees that we charge the firms that apply to be authorised to carry on regulated activities; and
- annual fees that we charge authorised firms to cover the costs of supervising them.

13.3 We aim to cover our costs in a way that is as fair and efficient as possible. Our fees usually reflect the size of the business, and are not intended to provide incentives for firms to be well managed or to act as practical supervisory tools.

13.4 The annual fee charged to a particular firm does not reflect the amount of work we put into regulating it because tailoring fees across all regulated firms would not be practical. Instead, we allocate our costs to 'fee blocks', which we define on the basis of the regulated activities firms carry on.

13.5 This means that firms carrying on similar activities are charged in the same way. It also means that they do not have to cover the costs for other firms that carry on activities that are not related to them.

- 13.6** Every year we consult on proposals that affect our regulatory fees and levies:
- in October/November we publish a Consultation Paper on new policies or changes to existing ones;
 - in March we publish feedback on the consultation responses and publish a Consultation Paper on fee rates to be charged for the coming financial year, taking account of feedback; and
 - in June we publish the final fee rates in a Policy Statement.
- 13.7** These are published on our website and firms can comment on any proposals that affect them. We invoice all firms, other than the very large ones, from July every year. Firms paying more than £50,000 in FSA fees make a payment on account in April that is equivalent to 50% of their previous year's fee, and are invoiced for the balance of the current year's fee in September.

Fees for interim permission

- 13.8** We are consulting in this paper on the fees we propose to charge OFT licensees who notify the FCA of their desire to obtain an interim permission (see Chapter 3). We propose that firms will pay a one-off fee for interim permission and we will not charge firms any other fees until they apply for FCA authorisation.
- 13.9** These fees will apply to all OFT licence holders who want to continue to carry out the activity for which they are licensed after 1 April 2014, except for not-for-profit bodies providing debt advice (see Chapter 4). The OFT charges sole traders a lower licence fee than other firms and we propose to maintain that distinction during the interim regime, although in the longer term we intend to differentiate our fees on the basis of risk as explained below.
- 13.10** Based on our estimate of the number of firms that will notify us that they want an interim permission, we propose to charge as follows:
- sole traders – £150; and
 - others – £350
- 13.11** The OFT currently exempts credit unions and some friendly societies from payment of licence fees. However, these firms do pay us for their FSMA authorisations, although discounted except for the largest credit unions. Their FSMA discounts reflect the fact that they operate in segments of the market for which few other FSMA authorised firms cater. Our current proposal is that these firms will pay a £350 interim permission fee. However, we would welcome views on whether this is the right approach for consumer credit.
- 13.12** Our draft rules on which we are consulting are set out in Appendix 1.

Authorisation and annual fees

- 13.13** Authorisation and annual fees for all consumer credit activities other than those included in our lower-risk regime will be calculated in a similar way to current FSA-regulated activities. There will be a separate, lower fee scale for lower-risk firms.
- 13.14** We are particularly conscious of the difficulties faced by not-for-profit bodies providing debt advice in funding the very important free service that they provide to vulnerable consumers and that requiring them to pay our costs through annual fees could affect the ability of some to maintain a free service. We aim to keep the FCA's regulation of them to the minimum necessary. The regulatory costs should accordingly be relatively low, but they must be recovered.
- 13.15** A significant number of the consumers seeking free debt advice are likely to owe money to the largest lenders. We, therefore, consider it appropriate that the largest lenders should meet the costs of regulating the not-for-profit bodies providing debt advice. We are accordingly exploring options for sharing these costs among the highest fee-payers.
- 13.16** We will consult on authorisation for consumer credit providers in the consultation paper on FCA fees that we are planning to publish in October/November 2013. We have put a number of assumptions about fee-levels into the financial modelling for the cost benefit analysis in Annex 3. The values were set in order to structure our calculations and should not be taken as indicative of the actual fee rates on which we will be consulting.

How the Financial Ombudsman Service (FOS) is funded

- 13.17** The FOS is funded by the financial services industry in two ways:
- a general levy, paid by firms that are in the scope of the FOS's jurisdiction¹; and
 - case fees for each complaint about a firm that the FOS deals with.
- 13.18** Each year we consult on the amount raised by the general levy. We also collect the general levy from FSA-authorized firms in the Compulsory Jurisdiction² on behalf of the FOS annually from July.
- 13.19** The FOS consults annually on the amount of the case fee, which is then approved by the FSA. From April 2013, the FOS proposes to increase the current case fee of £500 to £550 and to increase the number of free cases from three to twenty five.³
- 13.20** The levy operates differently for firms licensed by the OFT but not authorised by the FSA that are in the Consumer Credit Jurisdiction.⁴ The FOS calculates the amount it needs to operate the Consumer Credit Jurisdiction and the OFT then determines the amount payable by firms that are licensed only by the OFT. This is collected by the OFT every five years

1 Chapter 11 gives an overview of what FOS's jurisdiction covers.

2 We explain the Compulsory Jurisdiction in Chapter 11.

3 Financial Ombudsman Service, *Our plans and budget for 2013/2014, a consultation paper* January 2013.

4 We explain the Consumer Credit Jurisdiction in Chapter 11.

and passed to the FOS. The Consumer Credit Jurisdiction levy is currently £140, which is equivalent to £28 a year.

Our proposed approach to the FOS fees transition for firms

- 13.21** We have considered how to make the transition from five yearly to annual fees for firms that are currently licensed by the OFT and not authorised by the FSA. It is important that:
- the FOS receives adequate funding for dealing with consumer credit complaints;
 - the approach adopted is fair to firms; and
 - collecting the levy is practical and cost-effective.
- 13.22** We are not proposing to collect a general levy from firms that are currently licensed only by the OFT until they apply for FCA authorisation, as we do not consider it practical or cost-effective.
- 13.23** The FOS has set funds aside in a reserve⁵ to cover the uncertainty relating to future funding arrangements, including the regulatory changes for consumer credit. The FOS's annual funding need for firms in the Consumer Credit Jurisdiction, after taking into account funds already held and case fees, is £1.5m a year – less than 1% of the FOS's overall budget.

Summary of our proposals

- Firms (excluding not-for-profit debt advisers) will be charged a fee for interim permission (sole traders £150; other firms £350).
- We do not propose to collect a general FOS levy from firms with an interim permission to carry out consumer credit activities until they apply for FCA authorisation.
- We will publish a Consultation Paper in October/November each year to determine the fees to be paid by firms.

Q25: Do you have any comments on our proposed interim permission fees?

Q26: Do you agree with our proposed approach for the FOS general levy for firms with an interim permission?

⁵ Financial Ombudsman Service, *Our plans and budget for 2012/13, a consultation paper*, January 2012.

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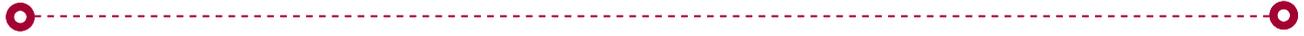
Next steps

- 14.1** Please send us your comments by 1 May 2013. We will review all your responses and publish our feedback on them. This will include our final rules/guidance for the two areas where we have consulted on draft Handbook material in this paper: the high-level requirements to come into effect on 1 April 2014; and our fees for interim permissions.
- 14.2** We will publish another Consultation Paper in the autumn, which will ask for your comments on the details of the proposed FCA regime for consumer credit, including the conduct standards that will apply from 1 April 2014.

Table 14.1 – Timetable of future FCA consumer credit papers

Expected date	Content
Summer/autumn 2013	Feedback on responses to this Consultation Paper.
Autumn/winter 2013	Second consumer credit Consultation Paper, covering all remaining aspects of the regime, including the conduct rules.
October/November 2013	Detailed proposals for fees, Financial Ombudsman and Money Advice Service levies.
Autumn/winter 2013	Consultation on plain language guidance to help firms and other stakeholders understand and navigate the new regime.
March 2014	Feedback on responses to the second consumer credit Consultation Paper, including made rules.
March 2014	Final version of plain language guidance for firms and other stakeholders.
March 2014	Fees proposals for 2014/15

- 14.3** Information on this document and any other material we publish about the new regime (including fees and information for firms that want to notify us that they wish to have an interim permission) will be made available through our website. Firms should also start considering whether they will need to make any changes to their business models or practices in light of the Government's and our proposals.



Stakeholder engagement

- 14.4** We will proactively engage with all our stakeholders, including consumer credit firms, trade associations and consumer groups, both during this and later consultation periods, and throughout the proposed transfer. It is important that you understand the implications of our proposals and give us your views. We will also do all we can to help achieve as smooth as possible a transition to the new regime.
- 14.5** We also want to ensure that consumer groups comment on our proposals and that we continue to identify the most appropriate ways of reaching consumers and what we need to say to them. We are meeting regularly with consumer groups and we will continue to do so.

Annex 1

List of questions

We would like to invite your responses to the following questions. Please ensure that your responses reach us by 1 May 2013 in order to be included in our feedback paper.

- Q1:** Do you agree that our proposals strike the right balance between proportionality and strengthening consumer protection?
- Q2:** Do you agree that we have included the right activities in the higher and lower risk regimes?
- Q3:** Do you agree that our proposals minimise the impact on competition within the regulated consumer credit market?
- Q4:** Do you have any comments regarding our proposals for the interim permission regime?
- Q5:** Do you agree that we should apply the Threshold Conditions as proposed?
- Q6:** Do you agree that it would be appropriate for the FCA to apply the approved persons regime activities as proposed?
- Q7:** Do you agree with our proposal not to apply a customer function to any consumer credit activity, particularly debt advice?
- Q8:** Do you agree with our proposed approach to appointed representatives and multi-principal arrangements?

- Q9:** Do you agree with our proposed approach to self-employed agents?
- Q10:** Do you agree with our approach to professional firms?
- Q11:** Do you agree with our proposal to apply prudential standards to debt management firms only?
- Q12:** Are there any difficulties in collecting data on the size of debt contracts being negotiated and/or the amount of client money held (as the basis for our prudential standards)?
- Q13:** Are there other measures that would ensure our prudential regime for debt management firms targets the firms that pose the greatest risk to consumers?
- Q14:** Do you agree with our proposals that the new high-level conduct requirements should apply from 1 April 2014?
- Q15:** Do you agree with our proposed approach to financial promotions?
- Q16:** Are there provisions within industry codes that you think should be formally incorporated into FCA rules and guidance?
- Q17:** Do you agree with the different standards that we propose to apply to different types of debt advice?
- Q18:** Do you agree with our proposed approach to applying client asset rules to debt management firms?
- Q19:** Do you have any comments regarding our proposed approach to peer-to-peer platforms?
- Q20:** Do you agree with our proposed approach to authorised firms which outsource the tracing of debtors to third party tracing agents?

- Q21:** Do you have any comments regarding our proposed approach to supervision and regulatory reporting?
- Q22:** Do you have any comments regarding our proposed approach to enforcement?
- Q23:** Do you have any comments regarding our proposed approach to complaints and redress?
- Q24:** Do you have any comments on our proposed approach to tackling financial crime?
- Q25:** Do you have any comments on our proposed interim permission fees?
- Q26:** Do you agree with our proposed approach for the FOS general levy for firms with an interim permission?
- Q27:** Do you agree with our market failure analysis?
- Q28:** Do you agree with the costs and benefits identified?
- Q29:** Do you have any comments regarding our proposed approach to second charge lending?
- Q30:** Do you agree with our initial assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?



Annex 2

Market failure analysis

1. Market failure analysis (MFA) identifies the economic drivers of risks to the FCA's overarching objective of making markets work well for consumers, which in the case of consumer credit, are predominantly risks to consumer protection and threats to effective competition. The Cost Benefit Analysis (CBA) of the proposed new regime (see Annex 3) in part elaborates on how the risks identified in this MFA will be addressed by the regime and the benefits associated with this.
2. This annex discusses the key failures that can arise in the markets for consumer credit and highlights issues in specific markets that we believe are working least well.
3. This MFA is necessarily high-level because of the wide range of consumer credit markets and the diversity of products, firms and consumers in these markets.

Consumer credit and its importance

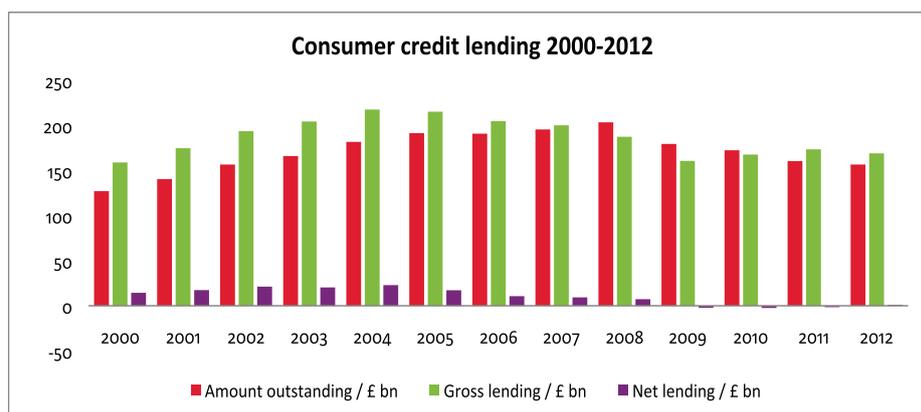
4. Consumer credit is an important product in the UK economy. It enables households and businesses to smooth their income (i.e. use expected future income to pay for current expenses) and so make financial commitments they might not otherwise be able to make. In addition, as most forms of consumer credit are unsecured (i.e. do not require collateral) they are typically more straightforward and quicker to obtain than secured forms of credit. Because of this, it is a key product for managing day-to-day finances and for funding certain types of expenses, for example, short-term or emergency expenses.
5. However, consumer credit also presents risks to consumers. Consumers may, for example, borrow an unaffordable amount, they may be sold an unsuitable product, or they may not get good value for money when borrowing, i.e., in principle, by paying more than the marginal cost for their credit (although we recognise that marginal cost pricing may not be realistic in markets where suppliers face high fixed costs).
6. The importance of consumer credit is evident in statistics on overall consumer credit lending. As reported in the recent National Audit Office (NAO) report,¹ for example, the Bank of England estimates that in the 2011/12 tax year, UK consumers borrowed £176

1 NAO 2012, 'OFT: Regulating Consumer Credit', available at: http://www.nao.org.uk/publications/1213/oft_regulating_consumer_credit.aspx.

billion in consumer credit.² Also, from the Bank of England (BoE), as of November 2012 there was £156 billion of debt outstanding in consumer credit, an average of about £6,000 per household.³

7. Current levels of borrowing are lower than pre-crisis, however, with the amount outstanding (£156bn) in November 2012 representing a reduction of 25% from its peak in September 2008 (£208bn). This fall indicates borrowers repaying existing debt and other factors, such as lenders writing off worst-performing loans from their loan books. Despite this fall, however, the continued high levels of gross lending indicate that consumer credit remains a highly valued retail financial product. Also, as can be seen in the recent lending figures, there are clear signs that the fall in net lending has effectively come to an end, which may suggest that lending will begin to increase again in the coming years. Figure 1 shows some of the key indicators of consumer credit lending over the past decade.

Figure 1 – Consumer credit lending 2000-2012



Source: Bank of England, FSA calculations

8. There have also been distinct trends in different consumer credit markets. For example, usage and amounts outstanding on credit cards have fallen post-crisis (BoE consumer credit data) while other forms of credit have risen, for example, payday lending and pawn-broking.⁴ Generally the signs are that, as costs of lending have increased and lending criteria have been tightened (e.g. reductions in credit card limits), some consumers have moved towards less mainstream, higher-cost credit products.
9. Generally speaking, risks associated with consumer credit will vary with the business cycle. Consumer credit volumes rise and fall with the business cycle as the risk appetite of lenders changes with the economic conditions and as demand for credit rises (or falls) as consumers

² This excludes student loans and is seasonally adjusted. For further information see the Bank of England's statistical releases: <http://www.bankofengland.co.uk/statistics/Pages/calendar/default.aspx>.

³ This calculation assumes there are 26.4 million UK households, data taken from the ONS. Please see: <http://www.ons.gov.uk/ons/rel/family-demography/families-and-households/2012/stb-families-households.html>

⁴ The OFT's recent report (p.7) on payday loans estimates that payday loans sector grew from £900m in 2008 to about £1.7bn to £1.9bn in 2012. See OFT Payday Lending Compliance Review – Interim Report, November 2012, http://www.of.gov.uk/shared_of/business_leaflets/consumer_credit/OFT1466.pdf.

become more (or less) confident about their future expected income. The nature of the risks can also change with the business cycle.⁵

10. There is a wide range of consumer credit products and related services that have evolved to meet the diverse needs of consumers and businesses. Credit providers include:

- credit card issuers;
- home credit lenders;
- payday lenders (online and bricks and mortar);
- pawnbrokers;
- deposit-taking institutions offering a range of consumer credit products (e.g. personal loans, credit cards, overdrafts);
- sole traders lending their own money;
- small businesses offering hire-purchase arrangements to consumer-hiring providers; and
- retailers selling goods and services on credit.

Among the credit intermediaries there are:

- credit brokers advising on personal loans;
- mail-order firms;
- businesses offering deferred repayments; and
- motor and non-motor (e.g. furniture, electrical) retailers that offer credit (provided by bank or non-bank lenders) to their customers.

There are also firms providing services related to consumer credit, for example, debt management firms, charities providing advice to consumers and debt collectors offering services to firms administering debt.

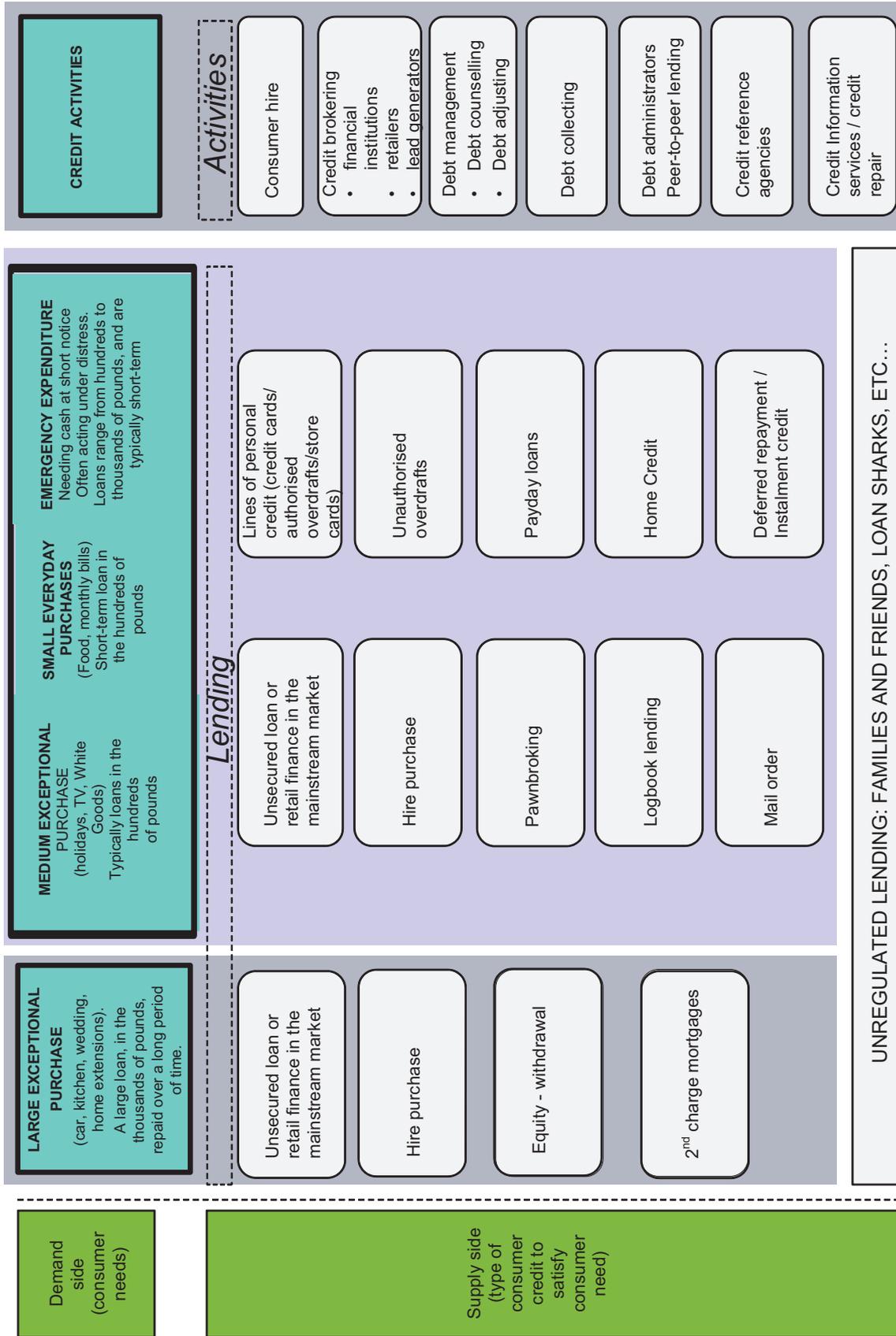
11. Figure 2 presents the main markets and the consumer needs these diverse markets serve. This diversity of markets is also reflected in the large number of firms that are active in consumer credit markets. The survey of the population of firms, which we commissioned Critical to carry out and is discussed in more detail in their report, estimates that about 48,000 firms are currently active in the market. The report by Critical also describes some of characteristics of the consumer credit markets in detail.⁶

12. On the right hand side of Figure 2 is a separate category of consumer credit related-activities that have value for borrowers, lenders or both. These include services related to selecting credit (brokers), managing existing debt for consumers (debt management), services provided to

⁵ For example, after a sustained period of continued economic growth, credit standards may relax to a point that very high-risk borrowers, previously excluded from the market, are granted credit that increases the risk of some of these being provided credit they cannot afford. Whereas, after a marked deterioration in economic conditions, there may be an increased risk that, with the increased number of borrowers struggling to repay credit, these are not treated adequately in relation to arrears charges, handling or forbearance.

⁶ See Critical (2012), *Consumer credit licence holders: Population and segmentation research* Key Findings and Technical Reports available on the FSA website.

Figure 2 – Consumer credit markets and the needs they serve



lenders to help evaluate the credit risk posed by prospective consumers (credit reference agencies), or to help debt administrators to recover payments from borrowers (debt collectors).

Drivers of demand, supply and competition in consumer credit markets

13. To understand consumer credit markets and the nature of competition in these markets, it is important to set out factors that affect demand, supply and competition. This section presents a high-level overview.

Demand-side drivers

14. In principle, consumers will consider credit if they perceive their income, savings and liquid assets to be insufficient for making some financial commitment. In considering credit, the key features we would expect to be influential are cost, the amount that can be obtained, how quickly and easily it can be obtained, and the time the consumer has to repay. Consumers will weigh these up depending on their preferences and circumstances (e.g. why they need credit, their disposable income, etc). Figure 2 distinguishes different products by the different consumer needs they can serve (large expenses, medium expenses, small expenses and emergency expenses⁷). A personal loan, for example, might be suitable for a large or medium expenditure, where the borrower has time to plan the expenditure, while a payday loan might be suitable where the borrower needs to fund an emergency expenditure at short notice. A loan from a pawnbroker might be a possibility in both circumstances.
15. The fact that different credit products can meet the same needs implies that, depending on a consumer's preferences and circumstances, some consumer credit products may be substitutes for other products. For example, the recent fall in credit-card borrowing and growth in payday lending borrowing could indicate that payday lending is being used as a substitute for credit cards, at least for some consumers.
16. In principle, we would expect consumers to consider first the least costly credit products available to them. However, the convenience and speed with which the credit can be obtained can also be an important consideration and may be more important than cost, for example, when the credit is needed for an emergency.
17. Also, the products available to a consumer depend on their circumstances, with mainstream credit products being more available to those with regular income and a good credit score. Other, less-mainstream credit products are designed for borrowers with more risky consumer profiles (irregular income, poor credit scores, or consumers that have exhausted all other available mainstream credit). As a general rule, credit products tend to become more expensive as they are aimed at higher-risk borrowers. So, as consumers suffer deterioration in economic circumstances, and so become higher risk, they are likely to find it more difficult to secure credit and are likely to face a higher cost of borrowing.

⁷ Where the consumer is acting under distress and/or when there is little time available to raise the needed funds, we would expect the consumer to draw on available credit lines and consider quickly attainable credit options with limited focus on the costs of credit. These distressed purchases are also more likely to be made with limited information and may be more prone to behavioural biases.

Supply-side drivers

18. Lenders will in principle provide credit where the price they charge for the credit (through interest, fees and contingent charges) more than covers the (marginal) cost of providing that credit. The credit risk of the borrower is a key factor here, as it is a major and uncertain driver of the costs the lender faces. This is particularly the case with unsecured lending where the absence of collateral means the lender can face a significant loss if a borrower fails to fully repay the loan, or to repay the loan on time. This makes information on a borrowers' creditworthiness particularly valuable to lenders, which means that past business with a consumer and credit scores from credit reference agencies can play a significant role in a lender's decision to lend and on what terms.⁸
19. The cost of funding is also an important driver of lender costs, though less uncertain than credit risk. High-street banks and building societies active in this market have traditionally funded consumer lending from retail deposits and used the direct distribution channel to offer credit to customers in the form of personal loans and overdrafts. Banks and building societies also typically offer credit cards to their customers (which represents the most significant proportion of the overall consumer credit lending). Non-deposit taking firms active in various consumer credit markets, borrow money in the wholesale market and lend to retail consumers and small and medium enterprises (SMEs). Competing with these large institutions is a significant number of small firms who are lending their own money, including sole traders who as a group represent approximately a quarter of all consumer credit firms.
20. There is a wide spectrum of business models employed by consumer credit firms differing in the source of funding (retail deposits, wholesale markets, own money), the way products and services are sold (e.g. bricks-and-mortar and online, direct and intermediated sales) and the targeted group of consumers (mainstream, credit impaired, niche markets).

Distribution

21. Regarding the distribution of credit, in addition to these lenders that directly provide credit to consumers – for example, home credit providers, payday lenders, monoline credit card issuers, pawnbrokers and deposit-taking institutions (which sell a range of consumer credit products) – there are a large number of intermediaries who offer credit provided by a third party. For most of these intermediaries, however, their primary business is not consumer credit. For example, many retailers, motor and non-motor (e.g. furniture, electrical, jewellery) offer the facility to purchase their goods on credit at the point of sale. This can be an important aspect of their business model, particularly where their target consumers are not usually in a position to purchase the goods outright. Also, in some cases, the margin on the credit offered with the retail sale may exceed that on the retail product itself, and may even subsidise the price at which the retail products are sold.

⁸ Where it is difficult or costly for lenders to obtain reliable information on a borrower's creditworthiness, this may be reflected in higher charges to cover the cost of adverse selection. Payday lenders, for example, offer convenient and quick access to credit, in part by not engaging in a lengthy gathering of information about a borrower's credit history. This may partly explain the high cost of payday credit (relative to other credit products where more borrower information is gathered). However, even these lenders are likely to try to use the information available to infer a borrower's creditworthiness in the most accurate ways open to them (sometimes using innovative methods to do so).

22. There are also other credit brokers who offer credit but not at the point of sale. These range from price-comparison sites that provide referrals to, or arrangements of, a wide range of credit products (e.g. credit cards, personal loans) to Independent Financial Advisers (IFAs) and mortgage advisers who offer some credit products (e.g. arranging loans) alongside other products they offer. Some brokers focus primarily on arranging credit for borrowers who are struggling to manage their existing debt.

Factors influencing competition in consumer credit markets

23. Many consumer credit markets feature a large number of lenders and low or moderate concentration. However, some of the main consumer credit markets, such as credit cards, overdrafts and personal loans, are dominated by the large deposit-taking institutions. And some of the other consumer credit markets, though not dominated by deposit-taking institutions, are nonetheless highly concentrated and dominated by a few providers, for example, home credit.
24. High concentration and associated market power could be explained by the presence of entry barriers and economies of scale in consumer credit markets. For example:
- Smaller, less well-established firms are likely to find it more difficult to obtain funding and likely to face a higher cost of funding than larger, more established firms. In general, deposit-taking institutions have an advantage in that they are typically large and have a relatively low cost of funding, also they have access to retail deposits; attempts to enter the deposit-taking market at this level face significant barriers (regulatory barriers, difficulties attracting new deposits given importance of brand, network advantages, etc). Also, the scale of fixed costs in banking and the scope for these to be common costs provide advantages to incumbents offering multiple products.
 - Brand recognition is also an important driver of business in many consumer credit markets. For new firms who want to compete, this implies a need for significant investment in marketing to gain business.
 - In some markets, firms can take advantage of economies of scale. In home credit, for example, one provider has most of the market share, which is likely to be partly due to the high initial costs of setting up a network of agents and the cost advantages of running a larger network.
25. In some consumer credit markets, firms have some market power that stems in part from consumer behaviours, for example:
- Retail finance providers, who offer credit at the point of sale to enable consumers to buy the retailer's goods, often enjoy some local market power, from the convenience to the consumer of arranging the credit with the sale, and the fact that the consumer is likely to be focused on the retail product rather than the credit.
 - Consumers may not shop around sufficiently to exert competitive pressure on credit providers, for example, where they need credit urgently (e.g. for an emergency expenditure). Also, by bundling products together, providers can make it more difficult for consumers to shop around and for other providers to compete. For example, banks

and building societies often offer a personal current account together with overdraft facilities and credit cards, and may also offer preferential interest rates for personal unsecured loans.

- Consumers may not be in a position, or inclined, to switch credit providers. For example, consumers who are struggling to repay credit (e.g. have unauthorised overdrafts, late payday loans) would send a strong signal of poor credit worthiness to other lenders. They are likely to find it difficult to switch if they are unhappy with the service (e.g. arrears handling) or level of charges they are incurring. Higher-risk borrowers, (e.g. of payday lenders, pawnbrokers or of home credit providers) may be more inclined to remain with their existing provider rather than apply for credit from another provider and face the prospect of being rejected.
- Because of the information asymmetries and/or certain tendencies in consumer behaviour ('behavioural biases'), consumers may be inclined to choose credit products or services that are not the best value or the most suitable for them. This can in turn lead firms to compete to provide products that play to these information or behavioural limitations.

Market failure analysis and associated risks to the FCA's objectives

26. In consumer credit, there are two risks that are of particular concern to the FCA, the risk of harm to consumers and threats to effective competition. Threats to competition are closely related to those to consumer detriment in that ineffective competition drives poorer outcomes for consumers (e.g. through poor-value products or services).
27. It is important to note that consumer detriment can arise from income or expenditure shocks, from market failures, from regulatory failures or from some combination of these. For example, a consumer may be given a good-value, suitable loan that the consumer reasonably expects to be able to afford and where the loan provider exercises due-diligence and care in providing the loan. However, the consumer then later loses their job unexpectedly and is no longer able to repay the loan as a result. In this case, although there is consumer detriment (that may warrant action from other public bodies to assist the recently unemployed individual) it would not be a risk to the FCA's objectives, as no market or regulatory failure is present and there was no inappropriate behaviour by the provider of the loan.⁹ The general point is that consumer detriment is a concern to the extent that it arises from or is worsened by market or regulatory failures and/or where it arises from firm actions that are inappropriate given existing and appropriate regulatory requirements.
28. In consumer credit, there are some specific forms of detriment liable to arise from market failures that will be of key concern to the FCA. Note that these risks should be considered alongside the more detailed, firm-level risks that can arise at various stages in the product cycle and that are set out in Table 2.1, Chapter 2. The key risks are of consumer detriment from:
- consumers borrowing unaffordably and/or entering debt traps or spirals;

⁹ Other risks to the FCA's objectives could arise from other features of such a borrower's situation e.g. the risk that their arrears are not properly handled and, if the borrower makes use of a debt management firm or is subject to debt collection services, the risks that these are not carried out appropriately.



- poor-value credit or services (i.e. priced in excess of marginal cost, adjusted if appropriate); and
- conflicts of interest (e.g. adviser gives unsuitable advice because consumer cannot check adviser is acting in consumer's interests, is sufficiently competent etc).

29. We now consider each of these risks, highlighting the market failures that can lead to them and, where appropriate, which markets may be of particular concern. We conclude with a brief discussion of some other risks that may arise.

Risks of unaffordable borrowing, debt traps or spirals

30. Unaffordable borrowing can only occur if the borrower, lender (and the intermediary if there is one) agree to it. And in principle, it is in neither the borrower's nor the lender's interests to be party to a loan that the borrower will not be able to repay.
31. In practice, however, a borrower can have incentives to take out credit that they cannot afford, i.e. where their income is not sufficient to make credit repayments sustainably while covering their essential expenditures.¹⁰ Of particular interest is where borrowers want credit they cannot afford, while believing they can and will repay the credit.¹¹ In these cases borrowers may lack important information on the nature of the product, its price, or its terms and conditions. They may also have behavioural biases that make them willing to take on excessive credit: for example, they may focus more on an immediate need for credit rather than on whether they can repay in the long-term (present bias); they may be overconfident in their ability to make future payments; or they may be unduly influenced by how the information on the credit product is presented (framing bias).
32. Understandable pressures on borrowers, such as having little time and an urgent need to obtain credit can also make the borrower more prone to biases and more liable to overextend themselves when borrowing. Distressed borrowing is also more likely for borrowers who are already struggling financially, who also tend to be those who are most likely to be unable to afford the credit they need. This correlation between distressed borrowing and borrower vulnerability is likely to increase the risks of detriment from unaffordable borrowing.
33. Features of the product, marketing material or the sales context can exploit these biases and make borrowers more likely to borrow where they cannot afford it. Credit card teaser rates, for example, are arguably an example of a product feature that exploits framing and present biases. The teaser rate is typically emphasised in the marketing of the product (framing the product as cheaper than it really is) and the short-term low teaser rate also exploits borrowers who are prone to focus on their short-term ability to

10 The OFT 1107 (2011) 'Irresponsible lending - guidance for creditors' sets out guidance for creditors when assessing a borrower's ability to undertake a credit commitment in a sustainable manner. Here 'sustainable manner' is defined as the credit can be repaid by the borrower: without undue difficulty (meaning while able to meet other debt repayments and other normal/reasonable outgoings and without having to borrow further to meet these repayments); over the life of the credit agreement or, in the case of open-end agreements, within a reasonable period of time; out of income and/or available savings; and without having to realise security or assets. See: www.offt.gov.uk/shared_offt/business_leaflets/general/offt1107.pdf.

11 In other cases, borrowers may borrow unaffordably with the intention of *not* repaying the credit. In situations like these, the lender will lack important information about the borrower's willingness to repay and the borrower may be acting fraudulently to obtain the credit. These cases, however, are subject to market correctives as lenders incur losses and tighten their lending processes or reduce their risk appetite. Also, there are legal sanctions in place to disincentivise borrowers from obtaining credit in a fraudulent way.

- make repayments.¹² Teaser rates are often a barrier to entry to as they are funded out of substantial ‘back-books’ that are maintained, possibly as a result of inertia, on very poor terms for the consumers concerned.
34. Also, credit products that can be easily rolled over, incurring interest or charges in the process, may be a concern for consumers prone to present bias or procrastination, as these products can accumulate charges or interest rapidly under certain conditions (e.g. missed payments), increasing the risk that a borrower may not be able to repay the credit. This suggests that credit cards, overdrafts and payday loans may be markets with greater risks of unaffordable borrowing.
 35. Difficulties consumers may have in switching to better-value products when they are having difficulties repaying – for example from the fact that they are visibly not creditworthy to other lenders – can grant providers market power to charge higher fees or to lower the quality of the services they provide (e.g. poor arrears handling, inadequate forbearance), which can exacerbate problems with affordability.
 36. Lenders, for their part, may knowingly provide unaffordable credit under two situations. First, they may provide unaffordable credit where it is profitable to do so. This can occur if the lender can extract sufficient revenue from the over-extended borrower, even if they eventually default. So, for example, it might happen if the product or service involves significant upfront charges, or if the product is designed so that they can secure repayments even if the borrower is struggling. An example of the latter can be seen with some credit products, such as overdrafts or payday loans with continuous payment authority (CPA)¹³, as with both of these the lender can secure repayments from income that goes into the bank account, rather than depend on a borrower’s decision to make a repayment. Also, since these situations necessarily involve a borrower who pays excessively and borrows unaffordably, for example, a distressed borrower who is in urgent need of funds, this suggests that behavioural biases and information asymmetries are also likely to be playing a role in the lender’s ability to charge excessively.
 37. Lenders may also offer unaffordable credit if the cost of distinguishing between borrowers of different creditworthiness is greater than providing the same credit product to all of these, even where it is unaffordable for some of these borrowers. This is likely to be a factor in some markets aimed at higher-risk borrowers, for example, payday lending.
 38. In a relevant and current piece of work, the OFT has published its review of the compliance of payday lenders with its irresponsible lending guidance.¹⁴ The OFT gathered evidence about its concerns on the quality of the payday lenders’ affordability checks, the proportion of payday loans not repaid on time and the frequency with which payday loans are rolled over

12 Ausubel and Shui (2004) in their working paper ‘Time inconsistency in the credit card market’ indicate that consumers over-respond to introductory teaser rates in credit card solicitations relative to the length of the introductory period, see http://papers.ssrn.com/sol3/papers.cfm?abstract_id=586622.

13 For more on recent problems with CPA with payday lenders, see the Citizens Advice Bureau’s response to the OFT consultation on debt collection practices: http://www.citizensadvice.org.uk/index/policy/policy_publications/er_credit_debt/cr_creditanddebt/continuous_payment.htm. See also the OFT guidance for businesses engaged in the recovery of consumer credit debts on the use of CPA: http://www.of.gov.uk/shared_of/consultations/OFT664Rev_Debt_collection_g1.pdf

14 See OFT (2013) Payday Lending Compliance Review: Final Report. Available at: www.of.gov.uk.



or refinanced.¹⁵ They have found evidence of significant problems, for example, in relation to loans being rolled-over and refinanced, and over the adequacy of affordability assessments.¹⁶

39. Second, lenders may have incorrect information which leads them to mistakenly believe the borrower can repay the credit. This can happen where a borrower misrepresents their situation (e.g. overstates income) or leaves out important information (e.g. that they are approaching multiple lenders simultaneously) in their credit applications. Although this could lead to some unaffordable borrowing, we would expect a subsequent market correction once lenders discover these borrowers' true creditworthiness (and incur losses in the process). We would expect lenders to tighten their credit application process and, possibly, react by increasing the risk-aversion in their lending if they cannot effectively distinguish between good and bad borrowers.¹⁷
40. With credit intermediaries, there may be situations where intermediaries' incentives do not depend on whether the credit they arrange is affordable. This could happen if an intermediary is profiting from the sale of an item that relies on the credit, but they are not sufficiently incentivised to ensure the credit is affordable. In these cases we would expect the provider of credit to respond (e.g. by providing suitable incentives for the intermediary by tying their reward to the affordability of the credit) once they discover that their credit is being irresponsibly sold, unless the credit provider also has incentives to lend irresponsibly.
41. The currently difficult economic conditions mean that households are under increased financial pressure, which may increase demand for potentially unaffordable credit and make it more difficult for borrowers to service their existing debt. In certain markets, including mainstream credit markets such as credit cards where the number of cardholders is extensive, this may increase the number of borrowers who enter into debt traps (i.e. able to make debt payments but not to reduce the principal owed) or into debt-spirals (i.e. unable to make sufficient repayments to the extent that the amount owed accumulates unsustainably). Debt traps and spirals are also more likely with forms of credit that can be readily rolled-over, accumulating interest or charges in the process (e.g. credit cards, overdrafts, payday loans).
42. On the supply-side, in many mainstream credit markets lenders have responded to the increase in credit risk by restricting the supply of credit (e.g. credit cards where credit limits have been cut dramatically). This restriction in credit supply has made it more difficult for households that rely on credit to manage day-to-day finances; some of these have had to move away from mainstream credit (e.g. credit cards) toward higher cost credit (e.g. unauthorised overdrafts, payday loans, pawnbrokers, home credit). As a result, some of the risks of unaffordable borrowing have moved from more mainstream consumer credit markets, such as credit cards, to these higher-cost credit markets.¹⁸

15 The OFT is also investigating concerns it has over the lack of forbearance shown by some payday lenders when borrowers get into financial difficulty and some debt collection practices.

16 See p.12, OFT 1466 (2012).

17 This could in turn have detrimental consequences for borrowers who can afford the credit and are willing to repay, but whom the lender is unable to distinguish from those borrowers who misrepresent themselves. These borrowers suffer from losing access to credit.

18 Note that this move toward higher-risk lending is not a market failure, but rather a 'fact of life' as lenders respond to the increase in the probability of default by borrowers.

Risks of poor value credit or services

43. One way consumers can experience detriment is by paying more than (in principle) the marginal cost of the credit product or service they have chosen. In addition to this being a risk to the FCA's consumer protection objective, this indicates a market where competition is not sufficiently effective. For that reason, the risks discussed in this section are also risks to the FCA's competition objective.
44. Consumers pay too much for credit or for a service where the price is persistently more than the marginal cost of providing it, i.e. where the provider exercises some market power they have. Market power can arise from a wide variety of factors, some of which have been discussed in the discussion of competition earlier in this Annex: barriers to firms entering the market, economies of scale, and economies of scope, all of which make it harder for new firms to enter the market to compete with existing firms. Consumer actions can also grant market power, for example, where consumers are unduly swayed by brand in their choices, where consumers find it difficult to shop around, or where consumers face obstacles to switching from products they are dissatisfied with.
45. Consumer choice behaviour, which is key to exercising effective competitive pressure on firms, is also influenced by the information available to consumers and how easy it is, and how willing consumers are, to gather information and act on it. For that reason, incorrect information and information-related behavioural biases can also act to give firms market power. As seen in the example of credit card teaser rates, this can lead competition to focus on features that are excessively profitable for firms.
46. Without a detailed study of the profitability of products and evidence indicating the causes of market power, it is difficult to state conclusively that certain consumer credit products are poor value. In some consumer credit markets, research has been carried out. In 2010, the OFT carried out a review of high-cost credit markets (the review included pawn-broking, payday lending and other short term lending, rent-to-buy and home credit. In total, these loans to consumers were valued at £7.5bn in 2008).¹⁹ This review highlighted demand-side concerns that stemmed from the relatively low ability and effectiveness of consumers in driving competition between suppliers (especially given their lower levels of financial capability). On the supply-side, concern was raised that sources of additional supply, such as mainstream financial suppliers, seemed to be limited and in such circumstances competition on price was limited. The review concluded that some suppliers appeared to be charging higher prices than expected.
47. In 2004, the OFT referred the home credit market to the Competition Commission, having found high levels of prices, low levels of switching among consumers and high levels of concentration. In 2006, the Competition Commission published its investigation into the home credit market,²⁰ where among their conclusions they found that 'profits ha[d] been persistently and substantially in excess of the cost of capital for firms that represented a substantial part of the market'²¹ and that there were no other consumer credit products that

19 OFT 1232 (2010) Review of high-cost credit: http://www.offt.gov.uk/shared_offt/reports/consumer_credit/High-cost-credit-review/OFT1232.pdf

20 See the Competition Commission's website on the investigation: <http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/home-credit>.

21 Competition Commission 'Home Credit Market Investigation' (p.7, 2006).

imposed an effective competitive constraint on home-credit. As a result, the Competition Commission introduced several measures to improve the effectiveness of competition in the market, including requiring home credit lenders to share information about borrowers' payment records and that lenders publish prices on price comparison websites to facilitate shopping around.

48. Another example where the OFT took action is in relation to unarranged overdrafts, where in 2007 it launched an investigation into unarranged overdraft charges, and subsequently, brought a test case against the fairness of these charges. Although in 2009 the Supreme Court decided that the OFT did not have the power to assess whether the overdraft charges were fair, the problems highlighted with unarranged overdrafts (high charges, complexity of charges) are indicative of some of the ways that competition in the personal current account market appears to be ineffective. In 2010, the OFT held discussions with the main providers of personal current accounts and they agreed to make further changes by giving consumers greater choice on whether to have an unarranged overdraft, including giving them greater access to tools to help them keep track of their balances (e.g. text alerts).
49. In its review of the current account market,²² the OFT found that there had been improvements around unarranged overdrafts and transparency of charges, and that associated revenue had fallen significantly. However, the review also found that charging structures for personal current accounts were still complex and comparisons between products remained challenging for consumers. Overall, the review concluded that competition concerns remain in the personal current account market and in particular that concentration remains high, new entry infrequent and switching by consumers low.
50. In relation to payday lending, the OFT's recent review of payday lenders' compliance with the OFT's irresponsible lending guidance highlighted a number of serious problems in the sector, many relevant to whether payday lenders are exercising market power and charging excessively. In addition, the report by the University of Bristol on the impact of a cap on the cost of credit will be taken into account in our ongoing work on the value of payday lending.²³

Risks from conflicts of interest

51. Consumers can face detriment when they enter into a contract with a consumer credit firm for a service, but lack information to adequately evaluate whether the service is carried out appropriately.²⁴ An example is where consumers engage a credit broker or debt adviser for advice on consumer credit options. In this situation, consumers are typically not in a position to fully evaluate whether the adviser is competent and acting in their interests when providing advice. This can lead to a variety of detrimental outcomes, such as debt management firms recommending inappropriate debt-restructuring solutions (e.g. that are unaffordable), or being offered credit by a broker that is not matched to their needs (in terms of what they can afford, repayment terms etc).

22 See OFT 1005rev (2013) 'Review of the personal current account market', available at: http://www.of.gov.uk/shared_of/reports/financial_products/OFT1005rev.

23 'The Impact on Business and Consumers of a Cap on the Total Cost of Credit', University of Bristol Personal Finance Research Centre.

24 In economic terms, this is a principal-agent problem, i.e. the consumer (the principal) lacks relevant information about the actions of the service provider (the agent) after the contract is agreed.

52. One particular, recent and extreme example of this has been evidence that some credit brokers have been charging an upfront fee to search for credit for high-risk borrowers, who are often distressed and struggling to obtain credit elsewhere, with in many instances consumers not being offered any credit, or being offered unsuitable credit. These consumers suffer detriment from losing the upfront fee (there is an associated problem in that many are unaware of their entitlement to a refund) and from the psychological detriment from the process. The problems in this market led to a super complaint from the Citizens Advice Bureau to the OFT in 2011,²⁵ to which the OFT responded with guidance clarifying consumers' right to refunds where the consumer does not enter into a credit agreement within 6 months and that firms were expected to notify consumers of their statutory right to a refund.²⁶
53. Moreover, in a recent review, the OFT found a wide range of non-compliance in debt management firms with existing regulation. Its report highlighted some key failures, including misleading advertising, frontline advisers lacking sufficient competence and providing poor advice based on inadequate information and non-compliance with, and awareness of, the Financial Ombudsman Service rules. These problems were exacerbated by the fact that debt-management consumers are often in a distressed situation and not in a strong position to evaluate whether the services being offered to them are suitable. In response, the OFT issued debt management guidance setting out fair practices in a wide range of areas,²⁷ including on providing pre-contract information to consumers and on the standards of advice that are expected in debt management firms.
54. An additional issue with debt management firms is that these firms hold consumer money while it is being processed for payment to the borrower's creditors. In this case, there may be some scope for the firm to misuse these funds for their own purposes to the detriment of the consumer. An extreme case would be where the firm is under severe financial pressure, where there may be temptation to draw on these funds to meet short-term financial commitments, to the potential detriment of the consumer, who may incur interest, charges or fees. Also, if the firm becomes insolvent, then consumers stand to lose payments that are being processed. This would be particularly a problem where debt management firms adopt a 'full and final settlement approach', attempt to negotiate a full repayment of the consumer's debt with their creditors, and where they may not be repaying creditors as the consumer makes payments to them.
55. Partly in response to these issues, the OFT guidance for debt management addresses how consumer funds should be handled.²⁸ This covers issues such as how client monies should be held in a separate ring-fenced bank account, how firms are expected to pay creditors normally within five working days of receipt of funds and that they are expected to have appropriate systems, controls and contingency plans in place. Our indicative proposals on

25 See OFT 1333 (2011), 'Marketing and charging practices in the sub-prime credit brokerage and debt management sectors: response to the supercomplaint by Citizens Advice', available at: http://www.of.gov.uk/shared_of/super-complaints/OFT1333.pdf. The report estimates that in the preceding 12 months 270,000 UK consumers paid an upfront fee to a sub-prime, unsecured credit broker on the expectation of being offered a loan.

26 The OFT also revoked the licence of a particular credit broker, Yes Loans, over its practices in 2012. See <http://www.of.gov.uk/news-and-updates/press/2012/15-12> for further details.

27 See OFT 366 (2012) 'Debt management (and credit repair services) guidance', which is available at: http://www.of.gov.uk/shared_of/business_leaflets/credit_licences/of366rev.pdf.

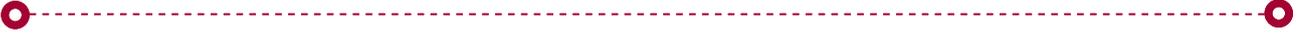
28 See p.63 of OFT366 (2012).

debt management firms, including both the prudential and client asset requirements being discussed in Chapters 6 and 8, aim to help mitigate the risks of this kind.

Other risks

56. In addition to the key risks there are other risks that could be associated with market failures. For instance, consumers can experience detriment when they are unable to access credit, access sufficient credit or access a sufficient variety of credit products, where they would be in a position to manage the credit. Consumers who are unable to access credit may suffer from having to do without or they may be pushed toward unregulated sources of credit. This may include friends and family, or worse, illegal sources of credit, with the risks that these entail.
57. There are several ways in which credit can become more difficult to access for consumers from market failures. First, there is the well-known adverse-selection problem associated with lending generally. This is the problem that lenders invariably lack some information about borrowers' ability and willingness to repay credit. This means that whatever credit terms and price they offer they can expect to attract those borrowers for whom this credit is under-priced (i.e. the less creditworthy borrowers) from those they are willing to offer credit to. This in turn is a problem since it incentivises lenders to overly tighten credit criteria and to reduce access to credit. It can mean that some borrowers, for example, those who have not built up a credit history, may have difficulty obtaining credit even if they are creditworthy. Second, market power can also lead to reductions in the accessibility of credit, so that if lenders are in a position to charge a price for credit above that warranted by the risk of the borrower, it will push borrowers to reduce the amount of credit that they demand and may even price some borrowers out of the market.

Q27: Do you agree with our market failure analysis?



Annex 3

Cost benefit analysis

Executive summary

1. The transfer of consumer credit regulation to the FCA, the policy proposals consulted on here and the indicative policy proposals, relative to a ‘baseline’ situation where no transfer takes place (i.e. the consumer credit regime stays with the OFT in its present form) are expected as a package to lead to:
 - **direct costs to the FCA of about £81m in one-off costs and about £25m per year in ongoing costs;** these costs will be recovered from consumer credit firms through fees;
 - **in addition to FCA fees, one-off costs for consumer credit firms of between £52m and £82m,** of which about £5m is expected in the interim regime and £47m to £77m is expected in the post-interim ‘steady state’ regime;
 - **again in addition to FCA fees, annual costs for consumer credit firms of between £10m to £21m in the steady-state regime;**
 - **benefits to consumers** from the proposed new regime will arise from correcting market and regulatory failures, as this will increase firms’ incentives to write fair contracts (that more closely reflect consumers’ true preferences) and to allocate them to the right people, so making consumer credit markets work better for consumers. This should lead to improved outcomes for consumers, from their borrowing more affordably, from their obtaining better credit products and services (from more effective competition) and from obtaining more suitable advice from debt management firms and credit brokers; and
 - **consumers will also benefit from transfers that we estimate to be in the broad region of £80m per year, which are expected to result from increased redress under the FCA’s regime.** However, as a transfer, firms will incur an equivalent cost in paying this redress.
2. **Including fees, firms are expected to incur additional one-off costs of between £90m and £132m from the interim regime and from adjusting to the steady-state regime, and annual costs including fees of between £29m and £44m in the steady state regime.** To help put these incremental costs into context, we also express them as a **proportion of annual turnover in consumer credit, one-off costs including fees are between 0.4% and 0.5% and annual costs including fees are between 0.1% and 0.2%.** However, these costs will vary by size of firm.

3. **Overall, incremental costs on all firms are low as a proportion of their consumer credit business.** One-off costs arise largely from a large number of small firms incurring a small cost in adjusting to the stronger regulatory gateway, supervision and reporting, and to review their systems and processes. Among large firms, one-off costs are largely expected from their review of systems and processes in preparation for the change of regulator. For small firms, ongoing costs are expected to arise from supervision and reporting, financial promotions and the appointed representative regime where applicable; while for large firms, ongoing costs are generally expected to be very low.
4. **With the generally low incremental costs on firms, the wider impacts (e.g. on competition, volumes of lending etc) of the proposed new regime are expected to be very limited.** In particular, we expect:
- **little impact on competition in consumer credit markets;** market exit due to the proposed regime and increases in barriers to entry are expected to be minimal for lenders; limited exit is expected among small retail intermediaries and credit brokers (predominantly among firms for which consumer credit is a small part of their business) with slightly increased barriers to entry in these markets; however, we expect consumers will still have access to a very large number of intermediaries and that this should not constrain credit supply;
 - **minimal impacts on volumes of lending and on the cost of credit;** overall, volumes of lending are not expected to be materially affected, with only a couple of distribution channels (e.g. point of sale credit) expecting a very slight decrease; in markets where some additional regulatory cost is expected to be passed on to consumers, average price increases are expected to be very low (i.e. a few basis points for nearly all segments considered); and
 - **minimal impacts on innovation or access to credit;** the low incremental cost of the transfer is not expected to be sufficient to drive material changes in innovation or to materially change access to credit for consumers.

Introduction

5. Since we expect that the changes proposed in this Consultation Paper (CP) will be made by the Boards of the FCA and the PRA rather than the FSA, this cost benefit analysis (CBA) follows the requirements set out in section 138I (FCA) and section 138J (PRA) of the Financial Services Market Act (FSMA) as amended by the Financial Services Act 2012.¹ These require the FCA and the PRA to publish a cost benefit analysis of their proposed rules, defined as ‘an analysis of the costs, together with an analysis of the benefits’ that will arise if the proposed rules are made. It also requires us to include estimates of those costs and those benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.

¹ An example of a rule proposed to be made by the PRA is a status disclosure rule about PRA authorised firms which have interim permissions for credit activities. Also, some rules will be made jointly by the FCA and PRA boards.

6. There are also special provisions that HMT propose to apply to this CBA (Articles 27 and 28 of the draft Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013). These state that the requirement to do a CBA does not apply to draft rules that are the same as, or substantially the same as provisions of the CCA or statutory instruments made under it or OFT guidance. Where the CBA requirement applies (GEN, SYSC & PRIN are in a number of ways different to previous CCA/OFT provisions) ‘cost benefit analysis’ means an analysis of the difference between the costs and benefits of the ‘Consumer Credit Act provisions’ and the costs and benefits that will arise if the proposed rules are made.
7. The CBA presented in this Annex is of the proposed overall consumer credit regime, which includes the transfer of the regime from the OFT, the rules being consulted on in this CP, and of high-level proposals (for which finalised rules will be consulted on in the subsequent autumn CP²) as a package. It does not just present a CBA of the rules being consulted on here (i.e. PRIN, GEN, SYSC and the specific rules for firms with interim permission) because the effects of these are inextricably linked with those of the rest of the proposed regime.
8. One can see this from the overlap in the effects of the requirements being consulted on in this CP, of the requirements that will be consulted on in the autumn CP and of the Government’s decision to transfer the regime from the OFT to the FCA. For example, consider that authorisation under FSMA (a change that results from the Government’s decision to transfer the regime) includes a threshold condition that a firm must demonstrate that it has appropriate financial resources, while Principle 4 (part of PRIN being consulted on this CP) requires that firms should maintain adequate financial resources. Also, the prudential standards (a change that we currently plan to consult on in the autumn CP) will require debt management firms to hold financial resources in the form of a certain amount of capital. In this case, there is no straightforward way to attribute the costs or benefits that will arise from firms increasing financial resources to the Government’s change in the authorisation requirements, the FCA’s current decision to apply PRIN or the FCA’s planned decision to introduce prudential standards.
9. Another difficulty arises from PRIN and parts of SYSC being high-level (i.e. they do not specify in detail how firms should act). For example, Principle 4 does not stipulate how much and what kind of financial resources a firm should have, and one would expect firms in different circumstances to comply in different ways. This introduces a further challenge for estimating costs and benefits, even where one can clearly associate costs and benefits with our proposed rules. The problem is that how high-level standards and principles will be acted upon by firms is inherently uncertain, and so it is difficult to infer effects and their extent without a large amount of information and some necessarily speculative analysis. This, combined with the complex and wide range of ways in which PRIN, SYSC and GEN differ from the existing consumer credit regime (see Chapter 7 for further details), makes it difficult to estimate in a reasonably practicable way some of the specific costs and benefits expected from the changes consulted on in this paper.
10. For the reasons given above, in the FSA’s opinion it is not reasonably practicable to estimate separately the costs and benefits of the draft rules attached to the CP. Instead,

² See, for example, the prudential requirements being considered for debt management firms, which are discussed in Chapter 6.

we have estimated the costs and benefits of the new proposed regime as a package relative to no transfer taking place, and we have split up the costs and benefits associated with different parts of the new proposed regime at a (slightly) higher level of granularity. Specifically, the costs and benefits associated with the following parts of the proposed new regime have been analysed:

- Interim regime
 - Authorisation, authorisation with limited permissions (includes parts of PRIN, SYSC that apply to authorisations)
 - Approved Persons
 - High-level Principles and Conduct Standards (includes most of PRIN, SYSC, GEN)
 - Client asset requirements for debt management firms
 - Prudential standards for debt management firms
 - Supervision and reporting
 - Complaints and redress
 - Financial promotions
 - Appointed representative regime
 - Retail conduct review (covers parts of GEN)
11. The detailed rules of the rest of the regime (e.g. prudential requirements, client asset requirements, reporting requirements) will be consulted on in an autumn CP and a revised CBA will be included to take these into account.³
12. By carrying out the CBA of the proposed consumer credit regime as a whole, we are presenting a picture of the effects from a broader set of changes. So the costs and benefits presented here are greater than those that would be expected were we able to present a CBA of just the rules (parts of PRIN, SYSC, GEN and the rules for interim permission firms) being consulted on.
13. To carry out the CBA we adopted the following approach:
- we commissioned the market research consultants, Critical, to carry out a large-scale population survey to identify firms currently active in the consumer credit market (sample of about 7,300 firms);⁴
 - we commissioned Policis, a research consultancy with specialist knowledge of the credit market, to carry out a more detailed quantitative and qualitative survey of firms (over 100 firms surveyed) to provide the data from which to estimate the effect of the proposed new regime on specific segments of the market; and

³ Costs and benefits presented in the CBA of the autumn CP will also differ from those presented in this CBA because of continuing work on the new requirements.

⁴ Critical (2012) *Consumer credit licence-holders: Population sizing & segmentation research* Key Findings and Technical Report. Available on the FSA website.

- Policis worked with Europe Economics (EE), a specialist economics consultancy, who used the results of the detailed survey to estimate compliance costs, to model the behaviour of firms as a result of transfer, and in particular, to model market exit likely to be caused by the proposed regime.⁵
14. To facilitate the analysis, consumer credit was divided into segments to reflect the different kinds of firms and activities in consumer credit. These segments fall into three broad categories: lenders, intermediaries and other firms. The lender segments are banks and building societies, monoline credit card issuers, traditional bricks and mortar lenders,⁶ online payday lenders, home credit lenders, other non-bank lenders and consumer hire firms⁷ and credit unions. The intermediary segments are credit brokers (including credit intermediaries not included in other segments), secondary credit brokers (motor), secondary credit brokers (non-motor) and aggregators and lead generators. Finally, the other firms include debt managers, debt collectors and administrators, firms providing credit information services (such as ‘credit repair’ firms) and credit reference agencies. Firms were also divided by the size of their consumer credit turnover to give some indication of how size would change the impacts firms might face; firms were divided between ‘small firms’ which have a turnover in their consumer credit business of less than £250,000 per year,⁸ and ‘large firms’ whose turnover exceeds this threshold.
 15. Much of this CBA is drawn from work we commissioned consultants to carry out. The population section is based on Critical’s survey and Europe Economics’ analysis of it. The compliance cost and wider impacts sections are drawn from Europe Economics’ report, which relied on a survey of currently active consumer credit firms carried out by Policis. For that reason, the consultants’ reports should be read in conjunction with the CBA for completeness. Also, as we are publishing these reports, much of the CBA presents the key findings of the consultants’ analysis rather than repeating detailed content already covered in those reports.
 16. The CBA begins with an overview of the population of firms regulated under the current consumer credit regime, as these are the firms that will be directly affected by the transfer of consumer credit regulation to the FCA. It then sets out the direct costs we expect to arise for the FCA, the incremental compliance costs we expect firms to incur, the wider impacts, for example, on competition, market exit, price and volume of lending, and how firms and consumers may be affected by these. The CBA concludes with an estimate and analysis of the benefits expected from the proposed new regime.

The population of consumer credit firms

17. For the cost benefit analysis and to help carry out our internal planning of the transfer, we needed to estimate how many firms have consumer credit licences. To estimate the

⁵ The Europe Economics report: <http://www.europe-economics.com/publications/15/publications.htm>

⁶ Bricks and mortar mainstream lenders include, for example, payday lenders and pawnbrokers with physical premises.

⁷ This segment covers consumer credit lenders that are not in the other lender segments and includes, for example, retailers that also provide credit at point of sale to their customers.

⁸ This £250,000 threshold was set on the basis of a judgment of how best to categorise firms taking into account the results of the Critical survey, FCA fees, and the risks likely to be associated with different firms.

population, we commissioned consultants (Critical) to carry out a survey of firms. See the Critical report for the detailed results of their survey.

18. For their modelling of the incremental compliance costs and wider impacts of the transfer, Europe Economics (EE) used the Critical survey, information from the Policis survey and their own research to construct their own population estimates.⁹ Table 1, drawn from their report, presents their estimate of the population. The EE report also provides explanations underlying their modelling of the baseline population.

Table 1 – Baseline population of consumer credit firms for CBA (EE report, Table 4.1)

	Estimated population as of April 2012	Pre-transfer exit range	Estimate of firms exiting pre-transfer (mid-point of range)	Estimated population pre-transfer if transfer were not to go ahead
Lenders				
Banks and building societies	126	negligible	-	126
Monoline card issuers	80	negligible	-	80
Traditional bricks and mortar lenders	560	0-5%	-14	546
Online payday lenders	80	negligible	-	80
Home credit lenders	500	0-5%	-13	488
Other non-bank lenders	6,270	10-20%	-940	5,330
Credit unions	400	negligible	-	400
Total:	8,016			7,050
Intermediaries				
Credit brokers and other intermediaries	16,400	10-20%	-2460	13,940
Secondary credit brokers (motor)	9,000	0-10%	-450	8,550
Secondary (non-motor) credit brokers	11,000	10-20%	-1650	9,350
Aggregators and lead generators	750	negligible	-	750
Total:	37,150			32,590
Other firms				
Debt management	1,700	negligible	-	1,700
Debt collectors and administrators	700	negligible	-	700
Credit reference agencies	8	negligible	-	8
Total:	2,408			2,408
Total (all firms):	47,574			42,048

⁹ Because Europe Economics drew on other sources than Critical, some of Europe Economics' population estimates differ slightly from those of Critical. See section 8.4 in their report for further discussion.

19. The population of consumer credit firms is not static. As Table 1 shows, EE modelled some net exit from segments of the consumer credit population to exclude exit not caused by the proposed new regime. The right-hand column gives the estimated population just before the transfer, taking this ‘natural’ net exit into account. This is the population of firms on which the costs of the transfer are estimated, i.e. the ‘baseline’ population for the CBA. We discuss market exits in more detail below.

Direct costs to the FCA

20. We have estimated the direct costs that we expect to incur as a result of the proposed regime. Using the estimates of the population of the consumer credit firms provided by Critical and the market exit estimates from EE, we carried out internal analysis of the likely resources we would likely need to regulate the consumer credit regime and estimated the direct costs we would face on that basis.
21. From this work, we estimate that we will incur one-off costs of about £81m before and over the transition period, and that we will incur ongoing costs of £25m per year after April 2016, once a steady state of firms in the market has been reached. The incremental one-off costs to the FCA result from a need for investment in IT systems as well as from a need for additional staff. These include staff for supervision, enforcement and in particular, staff to prepare and complete the interim permissions and authorisations before April 2016. The ongoing incremental costs (incurred post-April 2016) arise from a need for permanent additional staff, mainly split between the authorisation of new entrants, supervision and enforcement activity and the customer contact centre. Overall, we expect that about 250 permanent additional staff will be required for the ongoing regulation of the 38,600 firms (33,000 authorised or authorised with limited permission, 5,600 Appointed Representative firms) that we expect to be regulated for consumer credit post-April 2016.¹⁰
22. As with the FSA, the FCA will be funded only through the fees paid to it by the organisations that it regulates. For consumer credit regulation, the costs outlined above will be recovered from consumer credit firms through the one-off interim permission fee, the fees associated with authorisation, limited permission and variation of permission, and the annual fee applied to firms.¹¹

Compliance costs

23. Compliance costs are those that will be directly incurred by firms in becoming compliant with the new regime relative to the OFT regime. EE estimated the compliance costs on firms on the basis of the survey of firms carried out by Policis. The compliance costs are set out

10 Their 38,600 population estimate is taken from Europe Economics and is lower than the baseline population of 42,000 in Table 1 above, since it takes into account the market exit expected due to the regime. See Table 3 for the population of firms taking market exit from the regime into account.

11 Over a period of time between five and ten years (still to be decided) we will look to recover the programme and exceptional costs. This will be achieved through the interim permission and authorisation fees charged during the transition period, plus an addition to the annual periodic fees. Following recovery of these costs we will continue to levy annual periodic fees to fund the ongoing operations of the FCA Consumer Credit regime.

and explained in detail in the EE report. Here we present an overview of the compliance costs along with a short discussion of which segments they are likely to fall on and why.

24. EE's primary method for estimating costs was what they call their 'bottom up' approach.¹² This used firms' responses to the Policis survey, in addition to other information and research they had, to estimate compliance costs for firms that responded to the survey. They then used these individual firm estimates as an input to a behavioural model they had constructed to identify how these consumer credit firms would change their behaviour in response to the additional costs they faced (e.g. whether they would exit the market, stay in the market and absorb the additional costs, or pass some of the costs of regulation on to consumers through higher prices etc). This individual firm behavioural modelling was then used to identify the extent of market exit as a result of the transfer, which in turn was used to estimate the population of firms following the transfer and to construct estimates of the total compliance costs on consumer credit firms.¹³
25. As a sense-check and to provide a range for costs, a second 'top-down' approach was used by EE to construct another estimate of aggregate compliance costs. This did not rely on quantitative parts of the Policis survey. Instead it used other sources such as the qualitative interviews carried out by Policis and EE, FSA costs estimates from other CPs, and EE's past research to construct estimates for consumer credit segments as a whole (i.e. unlike the bottom-up approach, it did not estimate costs at an individual firm level). In addition to providing a sense-check, the top-down approach also provided estimates in areas where the Policis survey data from firms were insufficient.¹⁴ Moreover, in segments where the bottom-up approach was not feasible, behavioural impacts were modelled on the basis of the qualitative information provided in the Policis survey and by some interviews carried out by EE.
26. Table 2 presents the compliance costs estimates from the transfer for all consumer credit firms.¹⁵ Costs on small firms (consumer credit annual turnover less than £250,000) are presented alongside costs on larger firms (turnover greater than £250,000). These are EE compliance costs (See Table 4.2, EE report) net of estimated fees to the FCA (the interim permission fee, authorisation and limited permission fees, and the annual fee).¹⁶ Figures in the shaded rows include fees to the FCA; they are included to show how our (net of fees) figures relate to those in the EE report. Although small firms as a group bear a greater proportion of costs than large firms, this is due to there being a much larger number of small firms.

12 See section 4 of the EE report for further details on their approach to modelling costs.

13 Since this approach estimates future compliance costs on the basis of current business volumes, it does not take into account future changes to business volumes.

14 The segments where the Policis survey data was insufficient for the bottom-up approach were credit unions, small other non-bank lenders, aggregators and lead generators, small debt managers and credit reference agencies.

15 Peer to peer lending platforms are part of the population of firms analysed by EE. These platforms currently hold licences, including the category of debt administration, and are included within the debt collectors and administrators segment. Under the current regime, while there is some limited regulation of the platforms' relationship with borrowers, there is little regulation of their relationship with lenders. This will change under the FCA regime as the Government is introducing a new bespoke regulated activity covering both the lending and borrowing aspects of peer to peer lending. So, in addition to the effects on peer to peer platforms of the proposed new regime in their relationship with borrowers, which are covered in the cost estimates here, they will also be affected in relation to their dealings with consumers that are lending. Costs in relation to these will arise from the Government's decision to create the new regulated activity, our proposals to apply PRIN, SYSC and GEN to these firms, and from more detailed requirements we may consult on in future. However, at this stage, as details have yet to be fully decided, it is not possible to reasonably estimate costs that may arise in relation to these firms' business activities with lenders.

16 Costs are net of fees in line with the FSA convention of including fees under the direct costs to the FCA. For this reason, some of the costs presented here do not match those in the EE report where fees have been included.

Table 2 – Overview of compliance costs for entire consumer credit market

	All small firms /£m	All large firms / £m	All firms / £m
Interim			
Interim administration	3.7 to 4.5	0.4 to 0.5	4.1 to 5
Total interim one-off costs (excl fees)	3.7 to 4.5	0.4 to 0.5	4.1 to 5
Interim fees	8.9 to 10.9	1.2 to 1.5	10.1 to 12.4
Total interim admin and fees as in EE report	12.6 to 15.4	1.6 to 2	14.1 to 17.4
One-off costs			
Authorisation, authorisation with limited permission, VOPs admin costs	7.8 to 9.6	1.2 to 1.7	9 to 11.4
Approved Persons	2.6 to 3.4	0.7 to 2.6	3.3 to 5.9
High-level Principles and Conduct Standards (overall costs)	1.9 to 2.4	0.1 to 0.8	2 to 3.3
Client Asset Requirements for Debt Management Firms	–	up to 0.3	up to 0.3
Prudential Standards for Debt Management Firms	up to 0.1	0.1 to 0.8	0.2 to 0.8
Supervision and Reporting	6.8 to 8.5	0.6 to 1.3	7.4 to 9.9
Complaints and Redress	0.2 to 0.4	up to 6	0.2 to 6.5
Financial Promotions	4.1 to 5.9	0.4 to 1.4	4.6 to 7.4
Appointed Representative Regime	5.3 to 6.5	0.1	5.4 to 6.6
Retail conduct review ¹⁷	7.2 to 9.7	8.3 to 15.6	15.5 to 25.3
Total one-off costs (excl fees)	35.9 to 46.6	11.6 to 30.7	47.5 to 77.3
Authorisation, limited permission, VOPs one-off fees	15.2 to 18.9	13 to 18.3	28.3 to 37.2
Total one-off costs (incl fees, excl interim one-off costs) as in EE report	51.1 to 65.5	24.6 to 49	75.7 to 114.5
Ongoing costs			
Approved Persons	0.4 to 0.5	0.1 to 0.3	0.5 to 0.8
High-level Principles and Conduct Standards (overall costs)	0.1 to 0.2	up to 0.1	0.1 to 0.3
Client Asset Requirements for Debt Management Firms	–	up to 0.4	up to 0.4
Prudential Standards for Debt Management Firms	0.1	0.2 to 1	0.2 to 1.1
Supervision and Reporting	2 to 2.8	0.3 to 0.4	2.3 to 3.3
Complaints and Redress	0.1 to 0.2	up to 2.2	0.1 to 2.4
Financial Promotions	3.6 to 5.9	0.3 to 2.8	3.9 to 8.8
Appointed Representative Regime	3.1 to 3.8	0.1	3.2 to 3.9
Total ongoing costs (excl fees)	9.4 to 13.6	0.9 to 7.3	10.3 to 20.9
Annual fees	13.3 to 16.4	5 to 6.8	18.3 to 23.3
Total ongoing costs (incl fees) as in EE report	22.6 to 30	5.9 to 14.2	28.6 to 44.2

¹⁷ The costs of firms having to re-print materials (included in the conduct review costs) are not expected to be significant. This is because EE do not expect that firms will need to reprint contracts as a result of proposed new regime. See the EE report for further details.

27. To understand what these costs mean, it helps to have some background information about the population of firms in consumer credit. Figure 1 presents the distribution post-transfer of firms by segment – that is, the number of firms in each segment as a percentage of the number of all firms in the estimated post-transfer population. Figure 2 presents a useful contrast, which is the consumer credit turnover distribution by segment – that is the total consumer credit turnover in each segment as a proportion of all consumer credit turnover.

Figure 1 – Proportion of post-transfer consumer credit firms by segment

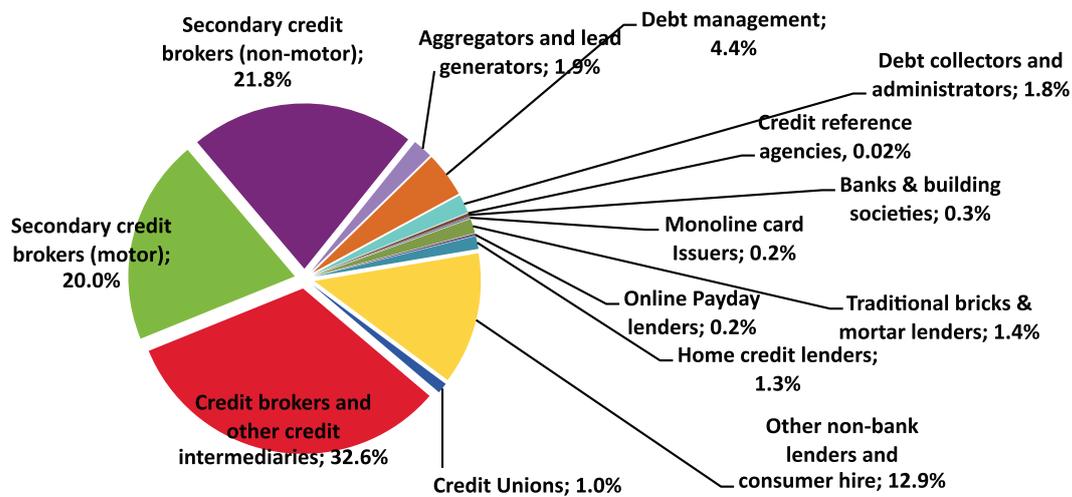
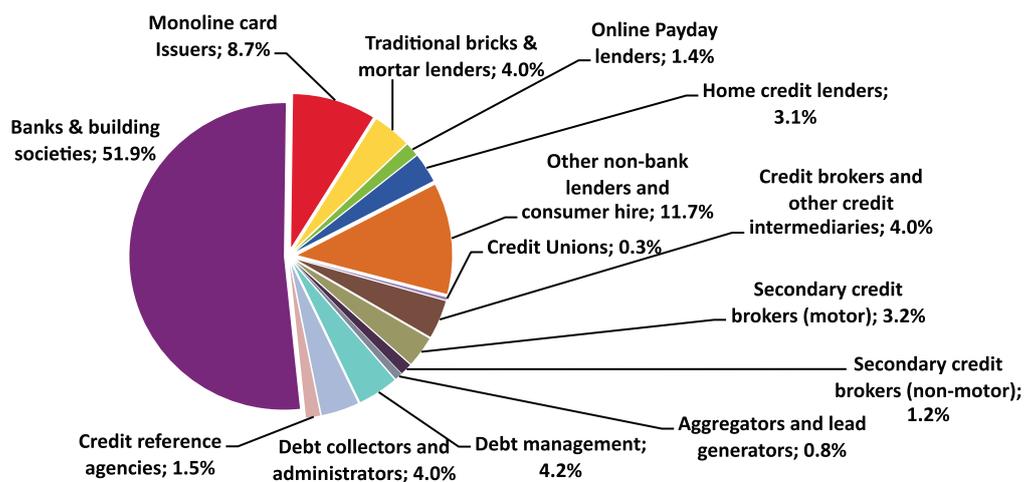


Figure 2. Distribution of consumer credit turnover by segment

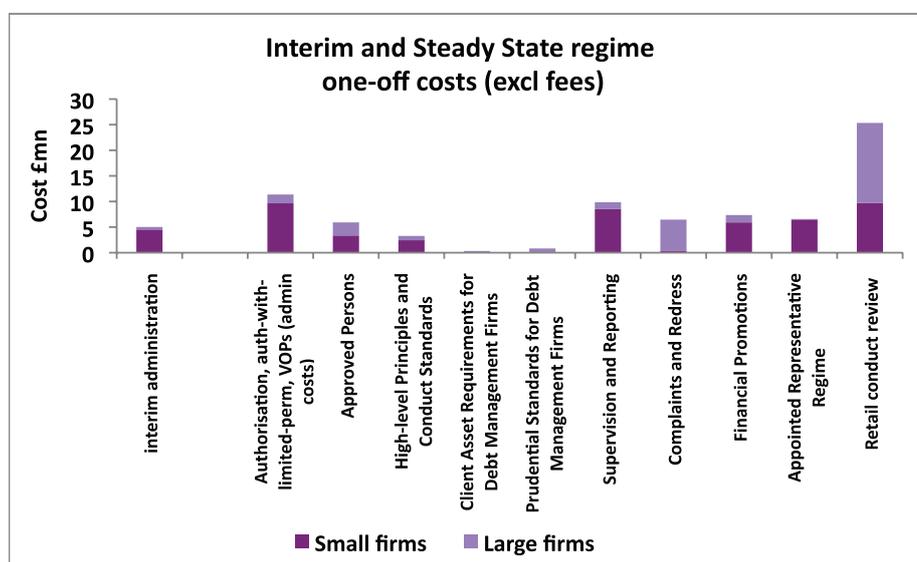


28. Figures 1 and 2 together show that while there are many credit brokers and secondary credit brokers, most of the consumer credit turnover is generated in the banks and building societies, other non-bank lenders and monoline card issuer segments. So while there are a large number of brokers and secondary intermediaries generating a relatively small value of consumer credit business, there are a few banks and monoline card issuers carrying out a

large amount of consumer credit business. Other non-bank lenders and consumer hire firms¹⁸ fall in the middle, with a relatively large number carrying out a significant amount of consumer credit business. This background information is helpful for interpreting the compliance cost estimates. For example, it helps to show whether costs falling on a particular segment will be split among a small or a large number of firms.

29. Figures 3 and 4 show the upper estimates for costs from Table 2. Figure 3 shows the one-off costs from the interim and the steady state regimes. Figure 4 shows the ongoing costs from the steady state regime.

Figure 3. Total one off costs (top of range) of the interim and steady state regimes



30. Figure 3 brings out some of the more significant compliance costs expected from the transfer. The main causes of the one-off compliance costs are:

- For small firms:
 - the costs of becoming authorised or obtaining a limited permission;
 - the costs of carrying out a ‘retail conduct’ review of their current systems and processes to check whether they will be compliant and where they may need to make changes;
 - the cost of adapting systems and training staff for the FCA’s supervision and reporting;

¹⁸ Other non-bank lenders are non-bank lenders that are not monoline card issuers, payday lenders, home-credit lenders. As discussed in the EE report (see section 4.9) these predominantly include lenders that supply credit at the point-of-sale of a retail product, both credit-providers with captive retail arms (i.e. the retailer only offers that lender’s credit) and those that offer credit via retail intermediaries with which they do not have a formal relationship; the category also includes consumer hire firms.

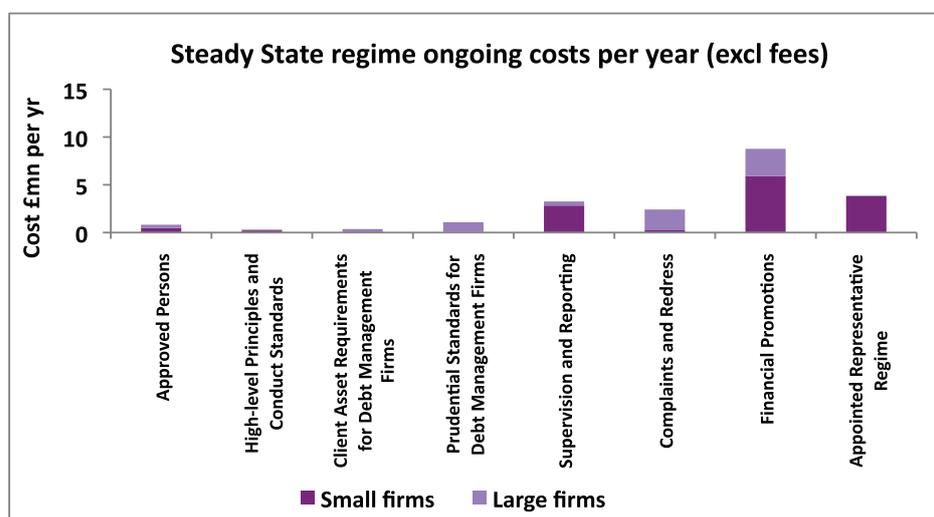
- the costs of becoming an appointed representative where small firms choose to do this;
- the costs of checking financial promotions; and
- costs of changing their processes to meet some of the new high-level standards.
- **For large firms:**
 - the retail conduct review, i.e. costs of reviewing systems and processes in advance of the change in regime¹⁹; and
 - costs of changing their arrangements for dealing with complaints, which stem largely from the proposal to require firms whose complaints exceed a certain number a year to publish complaints data.

The costs of the review could be even higher if, for example, the new regime included substantive changes in conduct rules.

31. Figure 4 brings out some of the more significant ongoing compliance costs expected from the transfer. These are:

- **For small firms** the main ongoing cost expected is from the increased administrative resources in meeting the more stringent FSMA requirements on financial promotions, followed by the ongoing costs of being regulated as an appointed representative (e.g. providing information to the principal) and the ongoing costs of providing information and filing supervision reports.
- **For large firms** there are three ongoing costs that stand out: costs of reviewing financial promotions to ensure compliance, cost of collating and publishing complaints data and the costs to debt management firms of increasing the capital they hold to meet the proposed prudential standards for debt management firms.

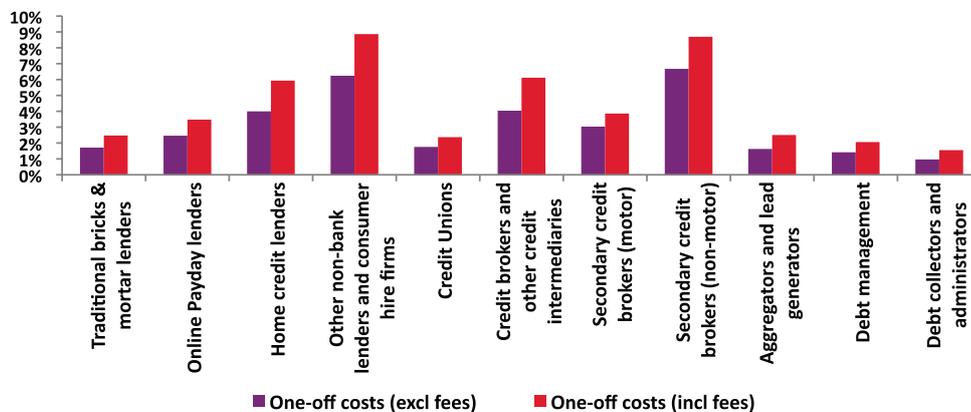
Figure 4. Total ongoing costs (top of range) of steady state regime



¹⁹ EE do not expect the retail conduct review to involve material costs of re-papering, see Section 1.2 in their report for discussion.

32. As presented, these costs do not bring out the segments that incur the most costs. To help bring this out for one-off costs, Figures 5 and 6 show the one-off costs of the steady state regime as a percentage of consumer credit turnover for both small and large firms. In addition to putting the scale of the costs from the transfer in context, presenting costs in this way makes comparisons between different consumer credit segments possible and meaningful. It is important to note that the costs per firm will vary by the size and other particularities of the firm.²⁰

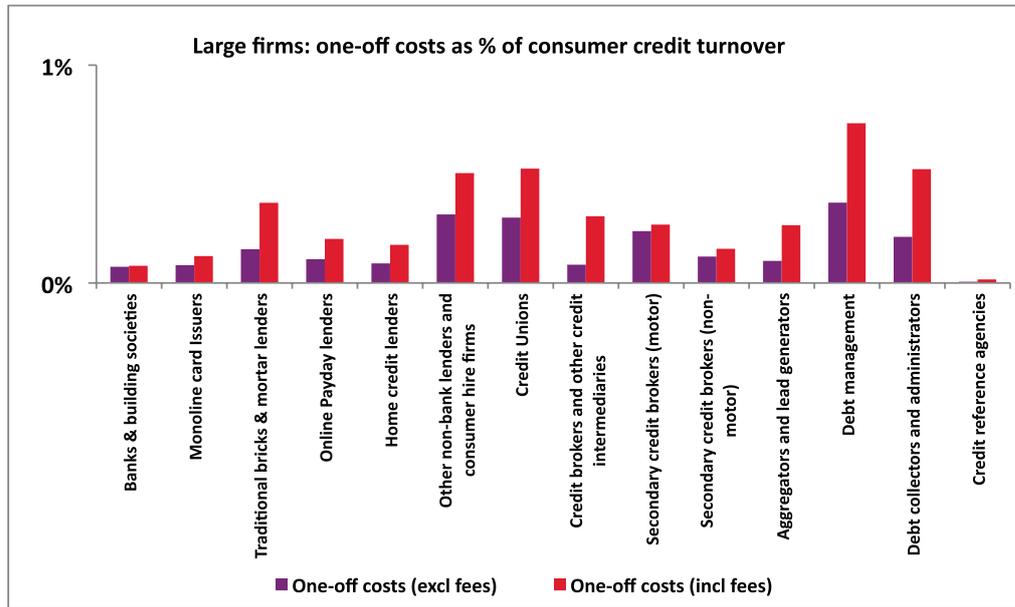
Figure 5. Total one-off costs (top of range) for the populations of small firms as percentage of consumer credit turnover in each segment



33. Figure 5 shows that, among small firms, we expect secondary non-motor credit brokers other non-bank lenders, home credit lenders and credit brokers to be most affected by one-off costs of the new regime. For credit brokers and secondary intermediaries, the one-off costs are in large part due to the sheer number of firms in these segments that have low consumer credit turnover but still have to incur some basic minimum of one-off costs in adjusting to the new regime. As one might expect, these incremental costs are not insignificant for some firms in these segments and, as we discuss in the next section, EE expects some market exit from the transfer in these segments.
34. In contrast, Figure 6 shows that for large firms, the impact of the one-off costs of the transfer is not expected to be particularly significant when compared to the turnover these firms have in consumer credit. The effects are less than a tenth of those on small firms and are likely to be minimal compared to fluctuations in costs from other drivers.

²⁰ For example, certain consumer credit markets may have relatively high fixed costs and low marginal costs. In this case, smaller firms are likely to face higher costs as a proportion of turnover.

Figure 6: Total one-off costs (top of range) for the populations of large firms as percentage of consumer credit turnover in each segment



35. Figures 7 and 8 show the ongoing costs of the steady state regime as a percentage of consumer credit turnover for small firms and large firms. Among small firms, it is again secondary credit brokers, credit brokers, other non-bank lenders and home credit lenders (once fees are taken into account) that are likely to be particularly affected. This is likely to be due to the fact that there are some basic minimum one-off costs that need to be incurred in moving to the new regime (e.g. time spent filing reports for supervision or reviewing financial promotions) and to the large number of firms in these segments with low consumer credit turnover.

Figure 7: Total ongoing costs (top of range) for the populations of small firms as percentage of consumer credit turnover in each segment

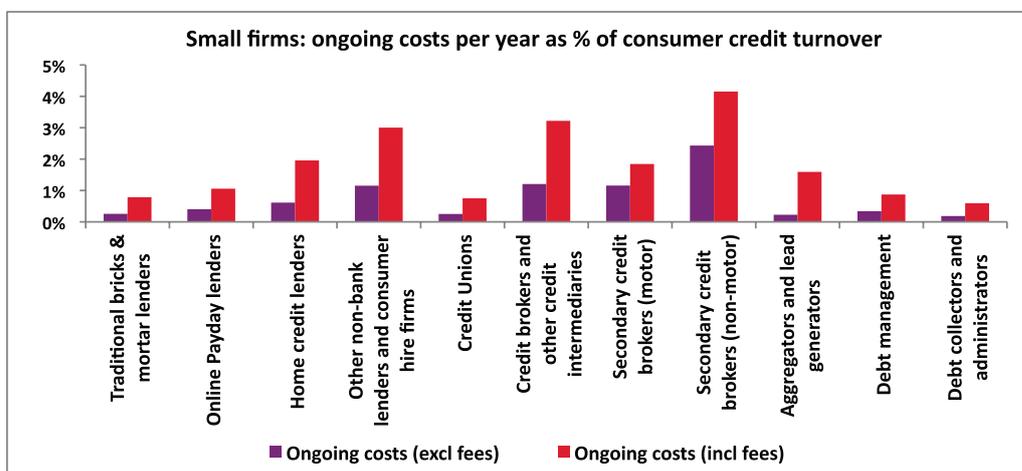
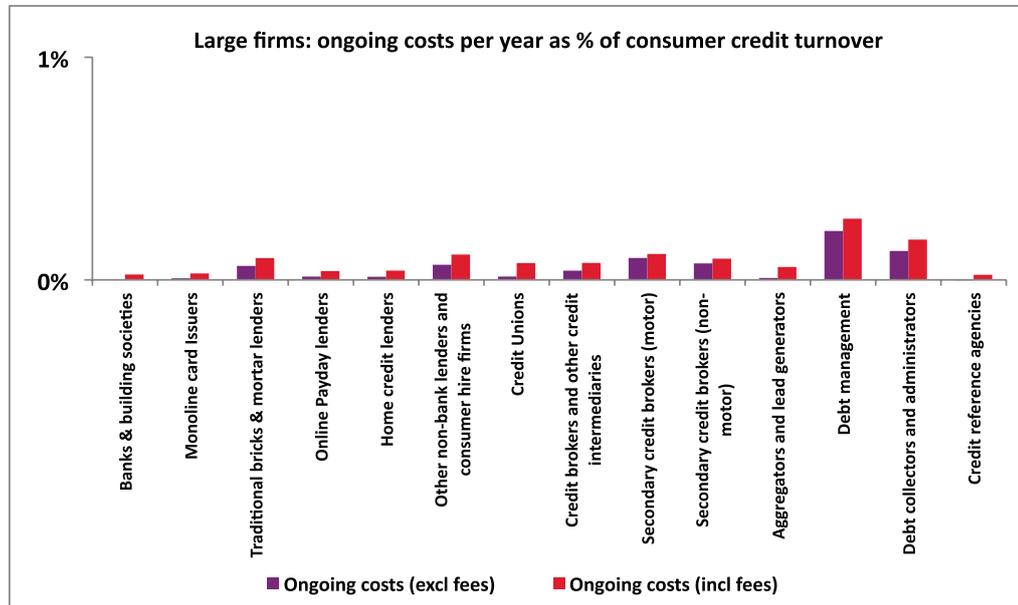


Figure 8: Total ongoing costs (top of range) for the populations of large firms as percentage of consumer credit turnover in each segment



36. Among large firms, the overall impact is again much smaller than for the small firms, although we see a noticeably higher, though still very low, impact among the large debt management firms. This is due largely to the impact of their having to hold a larger amount of capital to ensure they comply with the proposed prudential requirements for these firms.

Second charge loans

37. Firms dealing with second charge loans are also included in the population of consumer credit firms that will be regulated by the FCA from April 2014. A European Directive is being negotiated on mortgage credit which includes second charge loans. The Government has decided that these loans should sit within the consumer credit regulatory regime from April 2014. Once the negotiations of the mortgage directive are complete, the Government and the FCA will consider the longer-term regulatory treatment of second charge loans. See Annex 7 for more information on second charge mortgages.
38. Second charge mortgage lenders are included in the population of firms analysed by EE, so the incremental costs on these firms are included in the aggregate compliance cost estimates. However, since the costs falling on second charge lenders were not specifically estimated by EE, we constructed our own estimate of the costs specifically incurred by second charge mortgage lenders.
39. To do this, we assumed the cost of the proposed new regime on these firms to be similar to other small non-bank lenders and credit brokers. Therefore, on this basis, we estimate one-off costs for second charge mortgage lenders at between 4% and 6.2% of turnover and on-going costs at about 1.2% of turnover.
40. To estimate the overall costs to the second charge industry then requires an estimate of overall turnover. The Finance and Leasing Association (FLA), which covers approximately

85% of the market, estimates that there was £326m of new second charge loans granted in the year to December 2012. Scaling this up, we estimate total new advances in 2012 to be about £383m. Assuming conservatively that 20% of new advances represent industry turnover, we estimate one-off costs (excluding fees) on second charge lenders of between £3.1m and £4.8m and estimate ongoing costs (excluding fees) of about £0.9m per year.

Exempt Professional firms

41. Members of Designated Professional Bodies (DPBs) whose consumer credit activities meet certain conditions (see Chapter 5) will be able to carry out certain consumer credit activities under the supervision and regulation of their DPB rather than the FCA. These activities are currently regulated under a consumer credit group licence. Members, however, whose consumer credit activities do not meet these conditions, will need to become authorised (or authorised with limited permission depending on their activities) by the FCA. We would expect these firms to incur compliance costs similar in magnitude to those of other small firms described by EE, and for benefits to arise from improvements in the activities of these firms. Taking small credit brokers as a proxy for these firms, we would expect one-off costs (excluding fees) of about 4% and ongoing costs of about 1.2% of consumer credit turnover.
42. However, as these firms were not included in the population of firms analysed by Critical, Policis or EE, we do not have data on the number of these firms, or their turnover. For that reason, these firms have not been included in the aggregate cost estimates. We will be considering effects on these professional firms in more detail when we consult on the finalised proposals for professional firms in the autumn CP.

Wider impacts of the transfer

43. The wider impacts of the transfer are the knock-on effects of firms responding to the differences in the new regime and the increased compliance costs they will face. This can lead them to exit markets and change their business strategy, the products they are willing to offer and the prices they charge to consumers. This can then affect competition in the market (e.g. if the additional costs make it harder for new firms to enter the market), consumer demand (e.g. if increased costs lead to higher prices, reducing demand for credit) and outcomes for consumers (e.g. if firms decide to target different consumers because of additional costs of serving certain consumer groups). Drawing on the modelling carried out by EE, in this section we briefly discuss the wider impacts we expect from the transfer. More detailed discussion can be found in the EE report (see sections 4, 5 and 6).

Market exit and related impacts on competition

44. Wider market impacts will depend in part on the extent of market exit that we expect from the additional compliance costs and constraints the new regime imposes on firms. Using the bottom-up model and survey responses, EE modelled whether the firms surveyed are likely to exit the market from the change in transfer and they used this to estimate the proportion of firms in different segments likely to exit the market due to the transfer. Table 3 presents their results (see Table 4.1 in the EE report).

Table 3 – Impact on population of consumer credit firms from transfer

	Estimated population pre-transfer	Estimated exit from new regime	Estimated steady state population (mid-point of ranges assumed)
Lenders			
Banks and building societies	126	negligible	126
Monoline card Issuers	80	negligible	80
Traditional bricks and mortar lenders	546	negligible	546
Online payday lenders	80	negligible	80
Home credit lenders	488	negligible	488
Other non-bank lenders and consumer hire firms	5,330	5-10% small; 0-5% other	4,982
Credit unions	400	negligible	400
Total:	7,050		6,702
Intermediaries			
Credit brokers and other intermediaries	13,940	5-15% small; 0-5% other	12,576
Secondary credit brokers (motor)	8,550	5-15% small; negligible other	7,728
Secondary credit brokers (non-motor)	9,350	5-15% small; negligible other	8,428
Aggregators and lead generators	750	negligible	750
Total:	32,590		29,482
Other firms			
Debt management	1,700	negligible	1,700
Debt collectors and administrators	700	negligible	700
Credit reference agencies	8	negligible	8
Total:	2,408		2,408
Total population of firms	42,048		38,593

45. Table 3 shows that some market exit is expected for small firms in certain segments, specifically among non-bank lenders, credit brokers, and secondary motor and non-motor credit brokers. This is consistent with the cost impacts, showing higher costs as a proportion of consumer credit turnover for these firms. In these market segments, firms are expected to have little ability to pass on cost increases to consumers, so firms that are close to the margin of profitability in their consumer credit business are more likely to exit the market. This is particularly the case, for example, with small credit brokers where consumer credit is only a small part of their business and not significantly profitable, or with firms that may be particularly reliant on offering credit to support their retail sales, but where profitability is already under significant pressure for other reasons and the additional cost pushes the business beyond sustainability.

46. Among large firms, market exit is expected to be minimal overall, with the exception of a relatively small level of exit among non-bank lenders and credit brokers.
47. Among credit brokers, EE expect that the brokers remaining in the market would ‘pick up the slack’ from those exiting and that the exit would be unlikely to lead to impacts on lending volume through this distribution channel. Among secondary credit brokers ancillary intermediaries, they also expect some movement of consumers to substitute products (e.g. personal loans, credit cards) and so some reduction of lending through this channel. Similarly, among other non-bank lenders, they expect some substitution to point of sale loans provided by banks and so a small reduction in the volume of lending by this channel of about 3 to 4%. This is the only segment where EE expects an impact on the volume of lending.
48. Where firms remain in the market, despite facing increase in costs from the regime, they may – depending on the competitiveness of the particular consumer credit markets they serve – pass some or all of the increase in cost through to consumers (e.g. through increasing prices, reducing quality). In their analysis, EE expect some cost pass-through in certain markets. In particular, among bricks and mortar lenders, online payday lending, home credit and among non-bank lenders, where demand for lending may be less elastic (e.g. home credit borrowers often face few alternative sources of credit). Table 4 presents the pricing impacts EE expect in different segments (Table 4.30 of the EE report). As Table 4 shows, levels of cost pass-through are expected to be limited (up to a maximum of just over 15 basis points) and EE do not expect this, or the changes in the lending through the various distribution channels from market exit, to have a material impact on volumes of lending.

Table 4 – Potential price impacts on lending due to pass-through of costs to consumers

	Likely pricing impact	Maximum pricing impact
Banks and building societies	1bp	2 – 3bp
Card monolines	<1bp	1 – 2bp
Traditional bricks & mortar lenders	6 – 12bp	8 – 15bp
Online payday	3 – 6bp	4 – 8bp
Home credit	6 – 10bp	7 – 12bp
Other non-bank lenders	4 – 6bp	11 – 16bp
Credit unions	4 – 5bp	7 – 9bp

Other wider impacts

49. In addition to their modelling, EE also drew directly on the detailed survey carried out by Policis to discuss some of the other possible impacts from the transfer. In particular, they consider indirect effects of the transfer on:²¹
- **Product innovation:** EE note that uncertainty faced by firms associated with a switch to a new regime may lead firms to delay innovations, for example, until the new regime

²¹ See section 5 of the EE report for further details on these.

becomes clear to them. EE also mention the possibility that if the new regime were to alter competition in the consumer credit markets, this might lead some firms to forgo innovation. They qualify this, however, by noting that their quantitative modelling does not suggest the transfer will have a notable effect on competition.

- **Products offered and consumers served:** Drawing on the Policis survey, EE note (Table 5.3 in EE's report) that most lenders (68%) expect to make some changes (with modifying arrears management processes, or serving fewer high-risk consumers being the most likely among the changes expected). In contrast, most intermediaries and other firms do not expect to make any other changes. Since changes are driven mostly by changes in profitability from the transfer, we would expect, given EE's quantitative analysis, that such impacts would be most likely among other non-bank lenders and home credit lenders, who are more affected (in terms of proportion of turnover) by the compliance costs of the change in regime.
- **Barriers to entry:** Additional regulation can introduce a barrier to entry for firms wanting to enter the market. EE view the most likely effect to be on small firms looking to enter those segments where the one-off costs are significant as a proportion of turnover, for example, credit brokers, secondary credit brokers and some non-bank lenders.
- **Grey market:** The FSA (and the FCA in future) ensures that activities that should be regulated and firms that should be authorised are captured within our regulatory perimeter. However, there might be situations where consumer credit activities may take place in an unregulated though not illegal way (the 'grey market').²² Increases in the stringency of the regime can increase incentives for firms to act outside of regulation to avoid compliance costs and gain a competitive advantage over regulated firms. However, an increase in supervision and enforcement can also disincentivise regulated firms from engaging with firms in the grey market. EE see online services as the most likely area for grey market activity. In particular, they identify lead generation, where online firms can tactically exit and re-enter to avoid regulation, and online payday lending from firms outside the EEA as possible risks here.²³

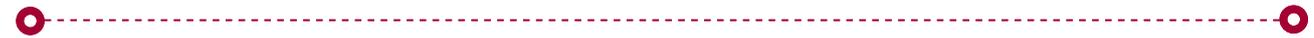
50. EE also discuss what they term the 'downside risk' that firms will become more reluctant to innovate, take risks, lend or even exit the market. Their identification of this risk draws on the qualitative survey carried out by Policis, where firms expressed concerns about how the FCA's approach will differ from the OFT, about how the FCA's interpretation of high-level principles and rules may change and on the possibility that the FCA may take unduly precipitate actions. As EE note, this is a matter of psychology and is driven by the current uncertainty attached to the new regime.

Implications for consumers

51. Wider market impacts can affect consumers, for example, through changes in the access to credit or changes in the price of credit. EE also considered these in their analysis (see Section 6 of their report) and concluded the following:

²² For example, an unauthorised firm based outside the EEA offers credit directly to UK consumers through a website.

²³ However, firms outside the UK but established in the EEA providing their services under the E-commerce Directive are regulated in their home EEA State. Non-EEA firms will be expected to be authorised by the FCA or PRA as appropriate.



- **Consumers' access to credit:** The market exit in certain segments (credit brokers, secondary intermediaries and other non-bank lenders) is expected to lead to some reduction in lending by secondary credit brokers and non-bank lenders, but to have little impact overall on volumes of lending. This is because of the firms remaining in these segments and consumers switching to substitute products. EE note, however, that consumers served primarily by these segments would experience reduced access to credit. However, EE acknowledge that lower income consumers may find it more difficult to obtain substitute credit products.
- EE also conclude that in most segments they do not expect material changes in pricing or marketing strategies from the increased compliance costs. Similarly, they do not expect firms to significantly change the consumers they serve as a result of the transfer. And finally, they do not expect the grey market to replace point-of-sale credit, the area most likely to be affected by a reduction in volume in lending. EE think it unlikely that banks and non-bank lenders would be willing to take this route because of the additional scrutiny it would be expected to attract from the FCA.
- **Choice of credit products and services:** EE do not think the market exit, impacts on innovation, or impacts on the incentives on firms to change their offerings will lead to a material impact on the choice available to consumers.
- **Cost of credit:** As Table 4 shows, price impacts on consumers are expected to be quite limited. EE also combine this with the Policis survey data on the different consumers served by different firms (see section 6 of the EE report) to estimate that higher-income consumers would be expected to bear more of the cost of this pass-through than lower income groups (e.g. EE estimate that the lowest income quintile would bear 13% of the total cost pass through, while the highest income quintile would bear 28%). However, we do not have information to assess whether lower income groups will be affected less as a proportion of income.

52. Together, this suggests that the overall impacts on consumers are expected to be small. Some small market exit is expected in some segments, but without this leading to significant reductions in the availability of credit. Similarly, price impacts, from the compliance costs being passed through, are expected to be limited and to fall more on higher-income consumers.

Benefits

53. The incremental economic benefits of the proposed new regime will arise from correcting market and regulatory failures and so making consumer credit markets work better for consumers. Overall, the welfare gain arises from our regime and its enforcement incentivising firms to compete on quality and price, by increasing firms' incentives to write fair contracts (that more closely reflect consumers' true preferences) and to allocate them to the right people.
54. In the context of the market failure analysis set out in Annex 2, this would be specifically from improved outcomes for consumers from their borrowing more affordably, from their

obtaining better-value credit products and services (from more effective competition) and from obtaining more suitable advice from debt management firms and credit brokers.

55. In many ways, the exact nature and extent of these economic benefits will depend on details of the regime (e.g. which markets the stronger authorisations regime most affects and where supervisory and enforcement actions will be focused) that have yet to be decided. However, the types of benefits we might expect are:
- **Reductions in unaffordable lending** from strengthened supervision and enforcing the existing CCA rules and OFT guidance on irresponsible lending, particularly in markets where there is currently evidence of problems (for example, in payday lending, which is currently being reviewed by the OFT).
 - **Reduced sales of poor value credit products or services**, for example, by the proposal being considered to require firms that receive large numbers of complaints to publish information on these, thus helping consumers to choose firms better and so helping competition to be more effective in these markets.
 - **Reductions in cases of unsuitable advice**, for example, from stronger authorisation requirements, conduct standards and the stronger supervision and enforcement (including of existing requirements) on credit brokers targeting vulnerable borrowers with up-front fee models.
 - **Reductions in losses of client money and assets**, for example, reducing risks to client money held by debt management firms, by introducing rules on the prudential capital these firms need to hold, and by increased supervision and enforcement of rules and guidance reflecting existing OFT guidance (on debt management firms) and through introducing stronger rules on the holding of client assets.
56. We are not in a position at this point to reliably estimate the economic benefits of the proposed regime. This is because of the interlinkages, explained at the beginning of this Annex, between the transfer of the regime, our high-level standards and planned proposals, and also because the exact nature and details of many of the regulatory requirements that will bring about those benefits have yet to be fully decided.
57. We can, however, provide an estimate of another important benefit, that is, the increased redress to consumers from the proposed new regime. Although this is a transfer (from firms to consumers) rather than an economic benefit, increasing redress firms pay can help bring about economic benefits if it incentivises firms to improve their standards in ways that addresses market failures discussed in Annex 2.
58. To construct a simple illustrative estimate of the increase in redress, we drew on the recent National Audit Office (NAO) report on the OFT. The NAO estimated that over the tax year 2011/12, for every £1 spent on enforcement by the OFT, consumers saved on average £8.60 from the OFT's enforcement actions in consumer credit. The transfer to the FCA will increase resources devoted to regulating consumer credit. From the estimated fee revenue of about £30m per annum one would expect the overall resource devoted to consumer credit regulation to approximately treble. For the £4.5m the NAO cites was spent on enforcement by the OFT, it estimates that consumers benefitted by about £40m over the year 2011/12.

As a very simple estimate of benefits, where one assumes that the FCA would have treble the resource on enforcement, one would expect (assuming the average benefit to consumers from enforcement action stays unchanged from the transfer) that the FCA would add another £80m in benefits from its enforcement actions over a comparable year, once the steady state regime is in place.²⁴ It is also important to note that, as a transfer, firms will incur an equivalent amount in costs in paying this redress.

59. The key mechanisms through which the benefits are expected to arise are as follows:
- **Better standards in the industry as a result of a stronger authorisation process, stronger supervision and enforcement** – there will be more scrutiny of higher-risk firms before they are allowed to operate in the market, more scrutiny of the integrity and competence of individuals in key positions in all firms; also more comprehensive supervision and wider enforcement powers will act as a deterrent for non-compliance.
 - **More flexible and stronger regulatory powers than the OFT** – rule-making powers will enable a quicker and more tailored response to product and service innovations that are harmful to consumers. The FCA’s rule-making powers will mean that it can react much more flexibly than the OFT, which, although it could issue guidance, relied on Parliament to make/amend regulations.
 - **Dealing with problems earlier** – the FCA will have more access to information about firms through their reporting, and more proactive supervision of firms. This, along with the freedom to make new rules, and to do so relatively quickly, will allow the FCA to take appropriate action in cases where there are systematic problems and to do so more quickly, thereby reducing consumer detriment.
 - **Improved access to redress** – the FCA will have the power to require firms to provide redress (reimburse consumers when they have lost out due to a firm’s actions.) This will bring benefits to consumers where redress is given, and should also incentivise firms to take due care when dealing with consumers.

How the proposed regime leads to benefits

60. The benefits of the transfer arise from the authorisation, rules, supervision and enforcement processes acting together. For this reason, we present in Table 5 a comparison of the ‘steady state’ regime against the existing OFT regime. We then discuss in more detail how the different parts of the regime lead to the benefits of the transfer.
61. The FCA regime will also be tailored to the nature of the firm and the risks it poses. Following the interim regime, firms, depending on their characteristics, will either need to apply to become fully authorised or to obtain an authorisation with limited permission, with the latter subject to a less intensive regime. The benefit of this over a uniform regime is that it matches the regulatory burden on firms to the risks they pose, so maximising the

²⁴ This estimate of benefits is a simplification, as in practice the increase in cost will not translate into an exactly corresponding change in resources, due to differences between the FCA and the OFT. We have not attempted to adjust the estimate for differences at this level of detail because a wide range of differences (salaries, staff training, quality of IT systems, location, etc.) can affect the efficiency of a regulator, and it is not practicable to analyse at this level of detail. Given the necessary simplification here, however, this estimate of benefits should be considered illustrative rather than a precise forecast.

FCA's ability to regulate consumer credit effectively by targeting its resources where it is most needed, while keeping costs on firms proportionate.

Table 5 – Differences between OFT and FCA (steady state) and associated benefits

	Regulatory gateway	Supervisory powers	Enforcement powers	Rules and the rule-making process
OFT regime	<p>Need licence</p> <p>Need to pass CCA fitness test for licence</p> <p>Group licensing</p>	<p>Takes account of 3rd party information intelligence, information and some data gathered proactively.</p> <p>Reviews of compliance</p>	<p>Can revoke licences</p> <p>Can impose conduct requirements on firms, if breached can fine up to £50k per breach.</p>	<p>CCA regulations, OFT guidance</p> <p>OFT can issue and amend guidance but changes to regulations require BIS secondary legislation.</p>
FCA regime (steady state)	<p>Authorisation requires meeting threshold conditions, more demanding than CCA fitness test, firms will also need to meet approved persons requirements for certain roles.</p> <p>Application requires greater information from firms.</p> <p>For firms authorised with a limited permission, only some threshold conditions apply (requirements will be more demanding than the CCA) and limit on the number of persons in a firm needing pre-approval.</p>	<p>All firms will have regular reporting.²⁵</p> <p>Authorised large firms, will be relationship managed, subject to regular review. Smaller authorised firms will also be subject to regular, though less frequent, review.</p> <p>Less intensive regime for firms authorised with a limited permission.</p> <p>More resources dedicated to following up with firms on issues raised by complaints and reporting.</p> <p>Will carry out thematic work in response to systematic issues.</p>	<p>Greater range of enforcement powers.</p> <p>Stronger sanctions</p> <p>Can enforce against breaches in approved persons and threshold conditions breaches.</p> <p>Enhanced policing of regulatory perimeter (i.e. of unauthorised firms) alongside Trading Standards' services teams.</p>	<p>FCA can issue new rules and guidance</p> <p>Though broadly similar to existing requirements of current regime, some high-level standards in FSMA will introduce slightly stronger and more general standards on firms (handbook sections: e.g. PRIN, SYSC, GEN).</p>
	General differences			

²⁵ Reporting rules will be consulted on in the autumn CP.

	<p style="text-align: center;">Specific differences</p> <p>Approved persons regime (e.g. compliance oversight officer, money laundering reporting officers).</p> <p>Appointed rep. regime (no group authorisation)</p> <p>(Handbook sections: COND, APER, FIT, GEN, PRIN, SYSC)</p> <p>Part 20 FSMA (i.e. under certain conditions members of designated professional bodies can carry out credit activity under regulation of professional body).</p>	<p>Depending on firm, 2-4 yearly risk assessment</p> <p>For smaller and firms authorised with a limited permission (4 yearly supervision engagement, level tailored to firm risk).</p> <p>Event-driven supervisory work focusing on firms as appropriate.</p>	<p>Powers to bring criminal, civil and disciplinary proceedings, to withdraw authorisation, ban from financial services, suspend firm or individuals for 12 months, issue fines (no limit).</p>	<p>Firms may need to publish complaints data if they receive more than a certain number per year.</p> <p>Prudential and enhanced client asset rules for debt management firms.</p> <p>FSMA financial promotion restrictions differ from model for regulating credit advertisements under the CCA.</p>
<p style="text-align: center;">Benefits</p>	<p>Greater scrutiny at gateway for higher – risk firms should improve standards of firms that stay in consumer credit.</p> <p>Approved persons should improve compliance in relevant areas.</p> <p>More information at authorisation will facilitate supervision and enforcement and improve compliance.</p>	<p>More information and monitoring to deal with problems earlier – the FCA will have more access to information about firms through their reporting, scope to take a market-wide approach by requiring action from all firms in a sector and proactive supervision of higher-risk firms.</p>	<p>More frequent and stronger enforcement actions should incentivise greater compliance and improved access to redress – the FCA will have the power to require firms to reimburse consumers when they have lost out due to a firm’s actions.</p>	<p>Quicker, more flexible rule-making process makes addressing problems quicker and more effective.</p> <p>High-level standards and complaints rules should improve compliance.</p> <p>Prudential/client asset rules on debt management firms should benefit consumers if firms fail.</p>

The regulatory gateway, authorisation and licensing

62. Under the proposed regime, all firms will face greater scrutiny of their applications to carry out regulated activities in comparison to the OFT. There will be a more challenging gateway for firms undertaking higher-risk activities (authorisation) and a less demanding threshold, lower-cost option for lower-risk firms (authorised with a limited permission). Among the higher-risk firms, if effective, this should disincentivise some currently non-compliant firms (that have yet to be identified as such by the OFT) from staying in the consumer credit markets, for fear of not being judged fit by the FCA or the PRA (if appropriate) or of facing enforcement penalties once regulated. The removal of these unfit firms at the gateway should benefit consumers, since these firms are likely to be currently causing consumer

63. The basic data that the authorisation processes will provide to the FCA and the PRA (as appropriate), along with the removal of inactive licences,²⁶ will help supervision and enforcement to identify firms posing risks and to act early to address them.

Appointed representatives

64. Most firms²⁷ will have the option of becoming an appointed representative of an authorised firm ('the principal') that agrees to the arrangement. Under an appointed representative contract, the principal agrees to be responsible for the appointed representative's regulatory compliance (under some kind of financial arrangement).²⁸ The benefit of allowing appointed representatives is that it provides for a less burdensome form of regulation for firms, as these no longer need to be authorised, while ensuring that regulation still applies to these firms. It also allows for potential economies of scale (e.g. one principal can incur the fixed regulatory costs for a number of appointed representatives, which lowers the cost of regulation per appointed representative).²⁹
65. In other words, the appointed representative regime offers a more cost-effective form of regulation for certain firms (i.e. for those for which it is less costly to engage with a principal than to be directly regulated e.g. smaller firms) than direct authorisation by the FCA. In doing so, it helps to reduce the cost burden of regulation (and any associated additional costs passed to consumers) relative to a transfer where becoming an appointed representative is not a possibility.

High-level standards

66. The transfer to the new regime will mean the high level standards (e.g. the principles (PRIN), the systems and control requirements (SYSC), the general provisions (GEN)) will apply. Chapter 7 discusses the proposals in relation to these in detail.
67. The principles in FSMA do not have a counterpart in the CCA regime. Currently, however, the OFT takes much of the substance of the principles into account when deciding whether an applicant is fit to hold a consumer credit licence. The principles cover areas which are not explicitly referred to in the CCA.³⁰ Nonetheless there are large areas of similarity, so for firms already compliant in the areas of similarity to the current regime, we would expect little change and limited benefits from the move to the principles

26 Under the current regime, some firms applied for many consumer credit activities, even in areas where they were not planning to be active. The FCA authorisation regime is designed to ensure that firms become authorised in consumer credit activities where they are planning to be active. This has the benefit of making the data on firms authorised in a current area more representative of actual activity than current OFT data on licensed firms.

27 As set out in Chapter 5, creditors cannot become appointed representatives, but can become principals. Credit reference agencies also cannot become appointed representatives.

28 Therefore, incentives for regulatory compliance for the appointed representative are set through the contractual arrangement between the principal and the appointed representative.

29 At this stage, however, it is difficult to predict how many firms will become appointed representatives and principals. In particular, since the lower risk firms will be subject to a lower cost regime, this will weaken their incentives to become appointed representatives. Because of this we would expect appointed representatives to be more likely among firms that carry out high-risk activities, for example debt management firms, for which the cost of becoming directly regulated is relatively costly (e.g. for smaller firms), provided there are firms willing to become principals for these firms, which at this stage is also highly uncertain.

30 Key examples of this are the requirement to have adequate risk management (PRIN 3), to have adequate financial resources (PRIN 4) and the broader requirements on communications with clients (PRIN 7) and relations with the regulator (PRIN 11). There is also the fact that PRIN is a set of binding rules, whereas some of the similar provision in the CCA regime is OFT Guidance, albeit that it is taken into account in decisions on fitness.

in FSMA. Where firms are not already compliant, and where this has not been identified by the OFT, there should be some change, particularly given the stronger sanctions the FCA will have to punish breaches.

68. In other parts of the high-level standards, there are also some differences that could lead to some benefits. For example, the Senior Management Arrangements, Systems and Control rules (SYSC) are in places broader and more detailed than requirements under the current regime (e.g. requirements under the CCA's fitness test and the extensive OFT Guidance). For example, the proposed requirement on a consumer credit firm (other than a sole trader with no employees) to appoint a Money Laundering Reporting Officer is a different and wider role to that required by the Money Laundering Regulations 2007 alone. Also, some of the requirements in SYSC, although similar to existing elements under the current regime, will apply as rules rather than guidance. For example, in relation to debt management firms, guidance on having practices for compliance and internal controls are not new, but under SYSC these will be rules rather than guidance, which with the FCA's greater powers to impose sanctions for breaches of rules, could incentivise greater compliance and lead to better outcomes for debt management consumers.
69. Other differences, though they will require firms to make changes, are unlikely to bring about material benefits. For example, the general provisions on firms (GEN) and analogous provisions that will apply to firms with interim permission will require certain FCA-specific standard disclosures; these are expected to have a material impact on firms, for example, from their having to update printed material or websites. In this case, although the changes are a necessary part of the transfer, we would expect few material benefits relative to the baseline situation where the transfer did not take place and the CCA pre-contract information and credit agreement disclosures remained in place.

Conduct standards and financial promotions

70. Broadly speaking, we propose to reflect the conduct standards in the CCA and in the OFT's extensive guidance in FCA rules. Rules and guidance will be consulted on in detail in the autumn CP. At this stage, since changes are not generally envisaged in relation to the substance in these standards, broadly we would not expect material benefits to arise. However, there may be benefits from the FCA's stronger supervision and enforcement regime.
71. One area where HMT proposes conduct standards should differ is in relation to financial promotions. The Government proposes to apply the FSMA financial promotions regime to consumer credit. This should have the effect of strengthening the financial promotions requirements, and again the rules on promotions will be consulted on in the Autumn CP. This could lead to some benefits from better information being provided to consumers, for example, from fewer misleading advertisements and a reduction in the consumer detriment that these can cause. Benefits might also arise from the greater flexibility of a scheme based on FCA rules rather than legislation and also the FCA powers to ban a financial promotion where the FCA considers there has been or is likely to be a contravention of financial promotion rules.

Approved Persons

72. Certain firms³¹ will be required to have persons approved by the FCA when becoming authorised, which will help the FCA to prevent unsuitable individuals from taking important roles. In addition, since approved persons are responsible for certain functions and supervision and (if necessary) enforcement attention will be directed towards them, this should help to incentivise these persons to improve standards in their firms. As a specific example, the likely requirements on debt management firms to have a person approved to carry out the compliance oversight function should help to raise standards in debt management firms and lead to benefits to consumers as a result.

Complaints and redress

73. Chapter 11 sets out the proposals in relation to complaints and redress. At this stage proposals are high-level and not finalised, with detailed proposals to be consulted on in our autumn CP. However, as discussed in Chapter 11, the transfer to the new regime will end the FOS's Consumer Credit Jurisdiction and bring firms under the Compulsory Jurisdiction (with the exception of non-profit debt advisers). A key change being considered here is that some firms (i.e. those that receive more than a threshold number of complaints over a stipulated time period) will need to publish complaints data. The publication of the complaints data should increase senior management focus on complaints and encourage improvements in complaints handling. It may also attract media attention, which could help consumers to evaluate the quality of these large firms better and encourage firms to compete on the quality of the services they provide to consumers. In this way, this rule could help to promote more effective competition among these firms and so improve standards (better quality and better value products and services).

Prudential and client asset requirements for commercial debt management companies

74. The prudential requirements, described in Chapter 6, will require debt management firms to hold prudential resources (e.g. share capital). The exact calibration of the prudential requirements for debt-management firms is to be decided and will be consulted on in the autumn Consultation Paper. However, for the EE analysis, an assumption on the prudential regime was made to understand the potential compliance costs for debt management firms. Therefore, the regime, for the purpose of this CBA, is assumed to require firms to hold capital resources equal to 2.5% of turnover with a floor of £5,000.
75. A prudential regime for debt management firms is aimed at reducing the risk of harm to consumers by ensuring that firms hold suitable financial resources against the business and financial risks that they face. The standards will also incentivise firms to run their businesses more prudently, which will also reduce the likelihood of consumer losses. It is important to note that consumers of debt management services are, by their nature, extremely vulnerable. Therefore, severe consumer detriment could occur if the firm became insolvent. By imposing prudential standards on debt-management firms, this risk should be partially mitigated, as the increased levels of prudential resources will aid an orderly wind down.

³¹ Not all firms will be subject to the approved persons regime, for example, sole traders. See Chapter 4 for further details.

76. In addition, client asset rules to be consulted on in the autumn Consultation Paper are being proposed for the largest debt management firms under the steady-state regime. These complement the proposed capital requirements on debt management firms and in some respects go beyond existing OFT guidance. Unlike the capital requirements, however, which act to reduce general incentives to act imprudently, the client asset rules act specifically to protect consumer assets held by the firm. Also unlike the capital requirements, these rules should be similar to already-existing OFT guidance which reminds debt management companies of their existing legal obligations when holding client money and gives guidance on how they should hold and monitor client money.³² Given this similarity, benefits from the client asset rules are more likely to arise from the additional requirements on debt management firms that hold client assets in excess of a threshold. These requirements (additional record keeping, regular reconciliations, bank requirements, annual audits) should further increase the likelihood that client assets will be returned to consumers in case of default of a large debt management company.

Supervision and regulatory reporting

77. The transfer will also bring about benefits from a strengthening of supervision and enforcement. With supervision, firms undertaking consumer credit regulated activities will for the first time be obliged periodically to report specified information to the regulator. In the steady state, firms will also be supervised under the Firm Systematic Framework, discussed in more detail in Chapter 9, which will match the level of supervisory monitoring to the size, complexity and risks posed by the firm.
78. The FCA will also undertake event-driven work from the information reported by firms and from other sources of information available. These data sources will also be used to identify market-wide issues affecting products or services which will support supervision, enforcement and rule-making actions. Although similar work was done by the OFT, the FCA will benefit here from its greater resources and from the existing data available to the FCA from the firms it already regulates. Taken together, the firm-specific supervision, the event-driven and issue-driven supervision work should permit the earlier identification and mitigation of event and market-wide risks. Benefits will also arise from the increased incentives that firms (and particularly higher-risk firms) will have to raise standards from being subject to a more intensive supervision regime.

Enforcement

79. The FCA will have wider enforcement powers, including much more substantial fining powers and the power to take action against individuals, supported by a continuing role for Trading Standards in combating illegal money lending and enforcing the retained provisions of the CCA. We envisage enforcement resources largely to be targeted at higher risk firms. On enforcement we expect the FCA to be able to take enforcement action against a greater number of non-compliant firms and to do so more quickly than the OFT could do, given the

³² See OFT366 'Debt management (and credit repair services) guidance', 2012, available at: http://www.offt.gov.uk/shared_offt/business_leaflets/credit_licences/oft366rev.pdf

limitations to its resources and powers, for example, the OFT was limited in the size of fines it could issue (£50,000) for a breach of the current regime.

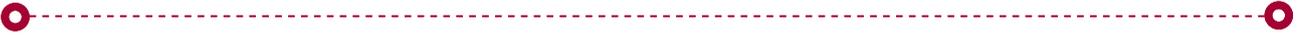
80. This should help bring about benefits by improving standards in certain firms, both directly (by acting to address non-compliance in firms against which enforcement action is taken) and indirectly, from the deterrence effect that these actions should have. The extent of benefits will depend on the current extent of non-compliance and financial crime. In areas where non-compliance is high and the FCA takes high-profile and effective action, there may be significant benefits from the deterrence effect this has.

Interim permission regime

81. This is described in detail in Chapter 3, but in summary the Government is proposing that firms with OFT consumer credit licences will be able to continue carrying out the regulated activities,³³ for which they have a licence after 1 April 2014 by notifying the FCA that they want to have interim permission and paying the required fee.
82. The high-level benefit of the interim permission regime relative to the baseline (of the transfer not going ahead) is that it provides some of the benefits of having consumer credit fall under the FCA, with its broader overview of retail financial services, and rule-making, supervision and enforcement powers. The interim regime also requires firms to provide some basic information to the FCA. This will be used by supervision and enforcement, enabling it to take earlier action in relation to observed risks of consumer detriment.
83. In addition, the proposed rules include rules which apply to firms with an interim permission. The main provisions concern how a firm must describe itself to retail clients and the required regulatory status disclosure to be used in letters or in electronic equivalents. For example, if a firm with an interim permission refers to its permission it must make clear in a way which is fair, clear and not misleading that it is an interim permission. The rules also set out specific disclosures that must go on firms' letterheads etc. In line with our discussion above of the benefits from similar changes from GEN, we would not expect material benefits to arise from these changes.
84. Relative to bringing in the full regime from April 2014, the interim permission regime has the benefits of not imposing undue costs on firms from their needing to adjust very quickly to the full FCA regime. Also, without a transition period, the new regime would be likely to increase market exit, pushing firms that would struggle to adjust quickly out of consumer credit markets, which would be unlikely to improve the effectiveness of competition or to benefit consumers.

Q28: Do you agree with the costs and benefits identified?

³³ To the extent described in their OFT licence. There are special rules in relation to credit broking, credit intermediation and lending on peer to peer platforms.



Annex 4

Equality impact assessment

Introduction

1. We are required under the Equality Act 2010 to consider whether our proposals could have a potentially discriminatory impact on groups with protected characteristics (age, disability, gender, race, pregnancy and maternity, religion and belief, sexual orientation and transgender). We are also required to have due regard to the need to eliminate discrimination and advance equality of opportunity when carrying out our activities.
2. We have conducted an initial equality impact assessment (EIA) of our proposals to ensure that the equality and diversity implications are considered. This annex sets out the results, explaining the potential impact of our proposals on protected groups where we have identified them and, where relevant, the steps we have taken or will take to minimise them.
3. The main outcomes of our initial assessment are that:
 - the proposals in this paper do not result in direct discrimination for any of the groups with protected characteristics;
 - there would be a number of positive impacts on the protected groups as a result of the strengthened consumer protections we propose to introduce, including prudential standards for debt management firms;
 - the proposals for the interim permission regime, authorisation, conduct standards and complaints have or will be tailored (once further developed) to minimise any potential indirect impact on some of the protected groups; and
 - we have not identified any equality or diversity issues arising from our proposals on appointed representatives, approved persons, supervision, reporting, enforcement, redress or preventing financial crime.
4. Our proposals for fees for interim permission (Chapter 13) broadly maintain the OFT's current differences between the fees charged for sole traders and other licensees. As sole traders disproportionately comprise women, ethnic minorities, the disabled and the elderly, our proposals would not treat groups with protected characteristics less favourably than

the existing OFT regime. We will assess the impact of our longer term fees proposals as they are developed.

Next steps

5. The EIA process is ongoing, and will not be completed until we develop and publish our final policy and until we undertake a more detailed consultation on all the rules and guidance that will underpin the new regime. As a result, at the end of this annex, we are seeking additional input from all stakeholders to help us further investigate and establish the extent of any potential impacts of the proposals in this paper.
6. We would also welcome any comments or information respondents may have on any equality and diversity issues they believe arise from our proposals.

Initial assessments

Positive impacts

7. We consider that the following proposals would lead to positive outcomes for all the protected groups:
 - Protected groups are disproportionately vulnerable to the risks in the consumer credit market (for example, those with a disability, those who do not speak English as a first language, or the elderly, may all be more susceptible to the risks associated with, for example, poor quality debt advice). In Chapter 2, we outline the risks to consumers and explain our aim of strengthening the regulatory regime to target the areas most likely to cause them problems.
 - In Chapter 4, we explain that not-for-profit bodies providing debt advice should not be required to have any approved persons. Instead, we propose to require profit-seeking providers of debt advice (such as firms that provide debt counselling and/or debt adjustment services in carrying on a debt management business) and credit repair firms to have a pre-approved Compliance Oversight Officer responsible for ensuring the compliance and competence of the firm's debt advisers. Providing this additional protection could lead to positive outcomes for all protected groups without affecting the availability of debt advice for the financially vulnerable (who tend to be over-represented by the protected groups).
 - In Chapter 6, we propose that debt management firms should be subject to prudential standards. These provide businesses with a degree of resilience on an ongoing basis so they have a greater ability to compensate consumers affected by bad practice/compliance failures and if a firm has to wind-down and close. We also propose, in Chapter 8, to develop additional rules on client assets, which would apply to the largest debt management businesses that hold the most client money.

- In Chapter 8, we propose individual consumers borrowing or lending via peer-to-peer platforms should be given enhanced protections.
- In Chapter 11, we propose that all micro-enterprises should be eligible to complain to the FOS about consumer credit. This additional protection would lead to positive outcomes for micro-enterprises operated by protected groups as it increases their access to FOS. We also explain that requiring not-for-profit bodies providing debt advice (currently operating under group consumer credit licences) to be subject to the FOS Compulsory Jurisdiction could affect the ability of some providers to continue to be able to provide free debt advice to consumers. So we will work with the FOS to develop our proposal that they should be able to opt-in to the FOS Voluntary Jurisdiction, which will not reduce consumers' access to free debt advice.

Age

8. We have not identified any concerns that specifically relate to age but, as our proposals develop, we will continue to ensure we consider age-related issues within our assessment.

Gender

9. We have not identified any concerns that specifically relate to gender but, as our proposals develop, we will continue to ensure we consider gender-related issues within our assessment.

Disability

10. We propose in Chapter 7 to bring across broadly the same conduct standards into our regime from the current regime. We plan to consult on the detailed conduct standards in the autumn.
11. Regarding disclosure provisions in the CCA, we are aware that consumers with reading difficulties or visual impairment may be disadvantaged by receiving information in a written form. In developing our proposals for consultation we will, where permissible under the Consumer Credit Directive (CCD), develop our rules and guidance so they do not prevent firms from meeting their equality obligations¹, especially when providing disclosures in ways that are accessible to all customers, i.e. large print, Braille or audio tape.
12. We will also be considering turning the OFT's Mental Capacity Guidance into FCA guidance². Our initial views are that it could be helpful to carry forward the existing OFT guidance on indicators that a borrower may have a mental capacity limitation, the steps

¹ Information about firms' obligations in respect of equality and diversity can be found here: <http://www.equalityhumanrights.com/advice-and-guidance/service-providers-guidance/your-responsibilities-when-delivering-services/>

² We welcome your views on which parts of the OFT Mental Capacity Guidance should be turned into FCA rules or guidance.

firms can take to help such borrowers to make informed decisions and the appropriate practices and procedures firms should adopt to enable better-informed lending decisions.

13. Some firms might request our interim permission notification/authorisation application forms or other information in different formats, i.e. large print, Braille or audio tape. Our normal practice is to accommodate such requests. Our electronic reporting submission system, which firms use to submit to us their regulatory returns, has been specifically designed to be accessible to sight-impaired users.
14. We have not identified any other concerns that specifically relate to disability but, as our proposals develop, we will continue to ensure we consider disability-related issues within our assessment.

Race

15. Consumers with difficulties understanding English may be disadvantaged by receiving credit information in a written English form. When developing our consultation proposals for conduct standards, we will draft our rules and guidance so they do not prevent firms from meeting their equality obligations, especially when providing disclosures in ways that are accessible to all customers, i.e. in other languages for those who have difficulty understanding English.
16. Some firms might request our interim permission notification/authorisation application forms or other information in different languages. Our normal practice is to accommodate such requests.
17. In relation to our proposals on preventing financial crime in Chapter 12, when tackling threats related to financial crime, the Money Laundering Regulations 2007 and our Handbook of Rules and Guidance require businesses to adopt a risk-sensitive approach. Equality and diversity issues may arise from how firms classify certain countries and jurisdictions as posing a higher risk and, as a consequence, take extra measures when dealing with customers connected to those places. Such classifications are necessary and justifiable, but we urge firms to consider whether the approaches they adopt to manage their risk are proportionate and whether there are steps they can take to mitigate any negative effects on individuals from those jurisdictions, and to ensure they remain compliant with legislation designed to prevent discrimination.

Pregnancy and maternity

18. We have not identified any concerns that specifically relate to pregnancy and maternity, but as our proposals develop, we will continue to ensure we consider pregnancy and maternity-related issues within our assessment.

Religion or belief

19. We have not identified any concerns that specifically relate to religion or belief but, as our proposals develop, we will continue to consider religion and belief issues in our assessment.

Sexual orientation

20. We have not identified any concerns that specifically relate to sexual orientation but, as our proposals develop, we will continue to consider sexual orientation issues in our assessment.

Transgender

21. We have not identified any concerns that specifically relate to transgender but, as our proposals develop, we will continue to consider transgender issues in our assessment.

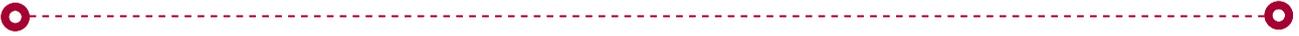
Marital status

22. While marital status is not specified as a protected characteristic in itself, we are required to have due regard to the need to eliminate discrimination on the grounds of marital status or civil partnership.
23. We have not identified any concerns that specifically relate to marital status but, as our proposals develop, we will continue to consider marital status issues in our assessment.

Impact of our proposals on the availability of credit and credit-related services for protected groups

24. We discuss, in Annex 2, the wider impacts of the transfer of consumer credit regulation to the FCA and the implications for consumers and conclude that, overall, the impacts on consumers are expected to be small. We also explain that whilst some small market exit is expected in some segments, this is not expected to lead to significant reductions in the availability of credit.
25. We would, however, welcome any information that respondents could share with us that could help us to continue to explore the impact of our proposals on the availability of credit products and credit-related services for protected groups.

Q29: Do you agree with our initial assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?



Annex 5

Compatibility statement (FCA & PRA)

Compatibility with the general duties of the Financial Conduct Authority

1. Since it is our proposal that the draft rules included in this CP would be made by the FCA (and in some cases the PRA) rather than the FSA, this Annex follows the requirements set out in section 138I of the Financial Services Market Act (FSMA) as amended by the Financial Services Act 2012.
2. When consulting on new rules, the FCA is required by section 138I FSMA to include an explanation of why it believes making the proposed rules is compatible with its strategic objective, advances one or more of its operational objectives, and has regard to the regulatory principles in s.3B FSMA.
3. This Annex sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

The FCA's objectives and regulatory principles

4. The proposals set out in this consultation primarily advance the FCA's operational objective of 'securing an appropriate degree of protection for consumers'.
5. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets¹ function well. Firms will have to meet higher standards to enter and operate in the market. We will require firms to comply with our Principles for Businesses (PRIN), such as that a firm must conduct its business with integrity (PRIN 1), that a firm must treat its customers fairly (PRIN 6) and that it must arrange adequate

¹ "relevant markets" are defined by s. 1F FSMA

protection for client assets (PRIN 10). Our Senior Management Arrangements and Systems and Controls sourcebook (SYSC) will also apply with respect to credit activity, which includes requirements to have robust governance arrangements (SYSC 4.1), employ skilled, knowledgeable and expert personnel (SYSC 5.1) and arrange for orderly records to be kept (SYSC 9). These obligations apply to authorised firms and so will apply to authorised credit firms, when consumer credit activities become regulated activities on 1 April 2014. The draft rules attached to the consultation paper make more detailed provisions, for example, that credit firms with limited permissions and with interim permission must make that position clear in communications with customers. Consumer credit financial institutions that are presently covered by the Money Laundering Regulations 2007, will need to appoint a Money Laundering Reporting Officer (see SYSC 6.3.9 as amended in the draft rules). This is a broader role than is currently required for those firms. We propose that individuals responsible for key functions to be pre-approved by us before they can carry out their role, while there will be new requirements that must be met by debt management companies in relation to protecting client assets, and holding adequate capital. The proposed detailed rules will be part of the Autumn consultation paper.

6. We consider that these proposals advance the FCA's operational objective of securing an appropriate degree of protection for consumers because we will target resource at the key risks and take action against consumer detriment as appropriate. Our framework gives us tools to deliver better outcomes for consumers through:
- Increased flexibility – rule making powers will enable a prompt and tailored response to product and service innovations that are harmful to consumers.
 - More resource will enable us to act on a wider range of issues.
 - Dealing with problems earlier – the FCA will have more access to information about firms through their reporting, scope to take a market-wide approach to requiring action from all firms in a sector and proactive supervision of the higher-risk firms.
 - Better standards in the industry – more scrutiny of higher-risk firms before they are allowed to operate in the market and significantly more scrutiny of the integrity and competence of individuals in key positions in all firms.
 - Improved access to redress – the FCA will have the power to require firms to reimburse consumers when they have lost out due to a firm's actions.

In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA. We set out below how proposals demonstrate such regard for each of the regulatory principles.

The need to use our resources in the most efficient and economic way

7. We propose to take a differentiated approach to firms according to the risk they pose to consumers and target our resources at the key risks. An example of this is that not-for-profit debt advice bodies will not be required to have approved persons (see draft rule SYSC 4.4.1R(2A)). This allows for resources to be allocated in the most efficient way.

The principle that regulatory burdens and restrictions should be proportionate to the expected benefits

8. A key principle in designing the regime is proportionality (see Chapter 2 and the CBA in Annex 3). For example, firms carrying on only certain lower risk activities who obtain a limited permission will be subject to reduced regulatory requirements.

The general principle that consumers should take responsibility for their decisions

9. Our proposals will ensure that consumers are treated in a fair way while still being responsible for their own decisions.

The responsibilities of senior management

10. A firm, when allocating functions internally, will have to ensure that senior personnel are responsible for ensuring that the firm complies with its obligations under the regulatory system (SYSC 4.3.1). We propose to vet individuals within key positions at consumer credit firms to ensure that they are up to the job and that, once in their role, they are carrying it out effectively and meeting their statutory requirements.

The desirability of the FCA exercising its functions in a way which recognises differences in the nature and objectives of the businesses it regulates

11. The proposed new rules are mindful of the need to recognise differences in firms. For example, we are requiring debt management firms to appoint a compliance officer, whereas this will not be required for other non-common platform firms.

The desirability of publishing information relating to persons

12. Our proposals include the regulators' new powers to publish information relating to investigations into firms and individuals, making the public aware of the action we take earlier.

The principle that we should exercise our functions as transparently as possible

13. We propose that the FCA will be an open and transparent regulator by publishing information, and requiring firms to publish information where this helps us to achieve our regulatory objectives.
14. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s.1B(5)(b) FSMA). We propose to require all firms to actively take measures to prevent themselves and their customers from being exploited by criminals. We will also require firms subject to the Money Laundering Regulations 2007 to take further measures, including appointing a Money Laundering Reporting Officer. See Chapter 12 for more details.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

Our proposals have regard to the desirability of sustainable growth in the medium and long term. The design principles included seeking to ensure no material impact on the supply of credit through unnecessary regulatory burdens on firms (see paragraph 4.16 below and Chapter 2)

Compatibility with the duty to promote effective competition in the interests of consumers

15. In preparing the proposals as set out in this consultation, we consider we have met the FCA's duty under section 1B(4) FSMA. This provides that the FCA must, so far as is compatible with acting in a way which advances the consumer protection objective or the integrity objective, discharge its general functions in a way which promotes effective competition in the interests of consumers.
16. As indicated, the proposals are principally intended to advance the consumer protection objective. We have taken care to design our proposals so that they target regulatory requirements where they are needed to secure an appropriate degree of consumer protection while minimising any adverse effects on competition. For example, our proposals for reduced requirements for lower risk firms that are eligible for a limited permission should help limit the regulatory burden on many smaller firms entering this market. This care is reflected in the report by Europe Economics, commissioned by the FSA to consider the potential implications for competition as part of their cost benefit analysis of the regulated consumer credit market. They found little material impact of our proposals on issues such as volumes of lending, price impacts, barriers to entry, access to regulated services, the ease with which consumers can change service providers, and product innovation.
17. Furthermore, the overall impact of the proposals and certain aspects of them may help promote effective competition. The improvement in firms' levels of compliance with regulatory requirements (arising out of enhanced scrutiny at the authorisation stage, more pro-active supervision and the deterrent effect of FSMA enforcement powers) may strengthen competition by making it more likely that firms compete on features that are of value to consumers. In addition, the specific proposals that improve the information provided to consumers should – in principle – help consumers to make more informed choices among consumer credit firms (for example, our proposal to apply Principle 7 will require firms to communicate information to consumers that is clear, fair and not misleading; and the proposal on large firms to publish complaints data).

Compatibility with the general duties of the Prudential Regulation Authority

1. Since we are proposing that the PRA will make some rules in relation to consumer credit, this Annex follows the requirements set out in section 138J of the Financial Services Market Act (FSMA) as amended by the Financial Services Act 2012.
2. When consulting on new rules, the PRA is required by section 138J FSMA to include an explanation of why it believes making the proposed rules is compatible with its general objective, the need to have regard to the regulatory principles and the need to have regard to minimising any adverse effect on competition that the way in which it discharges its functions may have.
3. The PRA's general objective is, when discharging its general functions so far as is reasonably possible, to advance the promotion of safety and soundness of PRA authorised person (section 2B(1) and 2B(2) FSMA as amended by the Financial Services Act 2012.
4. Section 2H(1) FSMA as amended by the Financial Services Act 2012 requires the PRA to have regard to the regulatory principle to minimise any adverse effects on competition in the relevant markets that may result from the manner in which the PRA discharges those functions and the regulatory principles set out in section 3B FSMA as amended by the Financial Services Act 2012.

The PRA's general objective and regulatory principles

5. The proposed rules are technical amendments necessary to ensure the appropriate application of the Principles for Businesses, systems and controls rules and general provisions to consumer credit activities carried on by dual-regulated firms.
6. The proposed rules amend the glossary and letter disclosures in relation to consumer credit activities. The draft rules attached to the consultation paper include more detailed provisions.
7. Firms that will be dual-regulated already comply with these provisions in respect of their other FSMA regulated activities. Insofar as these rules support an overarching framework of expected behaviour and are necessary to help firms understand their obligations under the regulatory system they promote the safety and soundness of these firms.
8. In preparing the proposals set out in this consultation, we have had regard to the regulatory principles set out in section 3B FSMA. We set out below how the proposals demonstrate such regard for each of the regulatory principles.

The need to use our resources in the most efficient and economic way

9. The application of the principles and high-level rules provides a reference point for all firms for their expected standards of behaviour, rather than depending on the regulator to specify this in detail.

The principle that regulatory burdens and restrictions should be proportionate to the expected benefits

10. The Principles and high-level rules already apply to the other regulated activities of PRA regulated firms. Extension to their consumer credit activities is therefore expected to be a minimal burden but will benefit firms by establishing a unified framework for their all their FSMA regulated activities.

The general principle that consumers should take responsibility for their decisions

11. Our proposals will ensure that consumers are treated in a fair way while still being responsible for their own decisions.

The responsibilities of senior management

12. Application of the systems and controls rules requires that a firm, when allocating functions internally, will have to ensure that senior personnel are responsible for ensuring that the firm complies with its obligations under the regulatory system (SYSC 4.3.1).

The desirability of the PRA exercising its functions in a way which recognises differences in the nature and objectives of the businesses it regulates

13. The proposed new rules are mindful of the need to recognise differences in firms.

The desirability of publishing information relating to persons

14. Our proposals include the regulators' new powers to publish information relating to investigations in to firms and individuals, making the public aware of the action we take earlier.

The principle that the PRA should exercise its functions as transparently as possible

15. We propose that the PRA will be an open and transparent regulator by publishing information, and requiring firms to publish information where this helps us to achieve its regulatory objectives.

Compatibility with the requirement to have regard to the need to minimise any adverse effects on competition in relevant markets that may result from the manner in which the PRA discharges those functions

16. The application of the Principles and high-level rules to the consumer credit activities of PRA firms is not expected to have any impact on competition because of the minimal impact of extending these rules to the consumer credit activities of PRA regulated firms.

Annex 6

The impact of our proposals on mutual societies

Introduction

1. The proposals set out in this Consultation Paper would affect a wide range of different firms in the consumer credit market. In particular, the rules it is proposed the FCA and, in some cases, the PRA would make would apply both to authorised persons which are mutual societies and other authorised persons. The draft rules can be found in Appendix 1 to this Consultation Paper. In line with s.138K FSMA, we must prepare a statement about the impact on mutual societies.
2. Section 138K FSMA provides that this statement must set out:
 - The regulators' opinion on whether or not the impact of the proposed rules on authorised mutual societies will be significantly different from their impact on other authorised persons¹: and

If so, details of the difference.

How does this affect different types of firms?

Building societies

3. Section 5 of The Building Societies Act 1986 sets out that a building society may be established only if its principal office is in the United Kingdom, and its purpose or principal purpose is making loans that are secured on residential property and are funded substantially by its members. As well as their principal purpose, they may carry on a wide range of other activities, such as other forms of lending and investment, money transmission services, banking and insurance services, where authorised to do so.

¹ We would welcome any comments or information respondents may have on any issues relating to mutual societies that they believe arise from our proposals.

4. We believe that there are six building societies currently active in the consumer credit market; others may have an OFT consumer credit licence but are not thought to be using it.
5. Building societies who wish to carry on credit related regulated activity after 1 April 2014 will be required to notify the FCA of their desire to obtain an interim permission and pay a fee of £350. We do not expect this fee to result in a significantly different impact on building societies than on other authorised persons.
6. We propose that PRIN will apply with respect to the carrying on of credit related regulated activities and ancillary activities in relation to credit related regulated activities, by building societies from 1 April 2014. They are already subject to these rules with regard to the other regulated activities they carry on, for example accepting deposits and activities in relation to regulated mortgage contracts. We do not consider that the application of these rules to regulated credit activities will have a significantly different impact on building societies than on other authorised persons.
7. Building Societies are already 'common platform' firms and the table in Part 3 of SYSC 1 Annex 1 summarises the application of SYSC to the carrying on of regulated activities and ancillary activities by common platform firms. Common platform firms require robust governance arrangements that are comprehensive and proportionate to the nature, scale and complexity of their activities (SYSC 4.1.2). We do not consider that the application of SYSC will have a significantly different impact on building societies than on other authorised persons.
8. We do not consider that the application of GEN (or the rules that relate to interim permission status) will have a significantly different impact on building societies than on other authorised persons.

Credit unions

9. Credit unions are registered under the Industrial and Provident Act 1965 in accordance with the Credit Unions Act 1979. A principal purpose of credit unions' business is the accumulation of members' savings to provide a fund out of which loans are provided for the benefit of the members.
10. Every credit union is either a version 1 credit union or a version 2 credit union. A version 1 credit union is a credit union whose Part 4 permission includes a requirement that it must not lend more than £15,000 in excess of a members shareholding.
11. Section 11 of the Credit Unions Act 1979 makes provision in relation to loans made by credit unions. The specialist sourcebook for credit unions (CREDS) provides that a credit union must establish, maintain and implement an up-to-date lending policy statement approved by the committee of management that is prudent and appropriate to the scale and nature of its business. The CCA does not currently regulate a debtor-creditor loan agreement if the lender is a credit union and the rate of the total charge for credit does not exceed 26.9%². The government has proposed carrying forwards the effect of this following the transfer.

² Subject to HMT consultation http://www.hm-treasury.gov.uk/d/credit_union_maximum_interest_rate_cap181212.pdf

12. Credit unions are already required to be authorised by the FSA to accept deposits and to comply with the FSA rules that relate to their existing FSMA regulated activities. The FSA currently takes a proportionate approach to the regulation of credit unions, and has developed rules appropriate to the nature of the sector. Credit unions are subject to PRIN, SYSC and GEN on a proportionate basis. For example, CREDS 2.2 provides that, for credit unions, the arrangements, processes and mechanisms referred to in SYSC 4.1.1R should be comprehensive and proportionate to the nature, scale, and complexity of the credit union's activities and that a small version 1 credit union will not be expected to have the same systems and controls as a large version 2 credit union. CREDS 10.1.3G provides that, in applying the Principles to credit unions, the FSA will be mindful of proportionality and, in practice, the implications are likely to vary according to the size of the credit union. Against this background, we consider that the impact of the rules relating to GEN, SYSC and PRIN, and disclosure of interim permission status, on credit unions will not be significantly different to their impact on other authorised persons.
13. Credit unions that wish to obtain an interim permission will have to pay a fee of £350. We consider that the interim permission fee could have a significantly different impact on credit unions as their business model, volume of lending and turnover can be very different compared to some other categories of authorised persons (such as major bank lenders).

Industrial and provident societies

14. Section 1 of the Industrial and Provident Societies Act 1965 sets out that a society may be registered under the Act if it is conducting an industry, business or trade, either as a co-operative or for the benefit of the community. Most industrial and provident societies are not regulated by the FSA under FSMA.
15. If an industrial and provident society has an OFT consumer credit licence and wishes to continue to carry on regulated credit activity following the transfer, it will be required to notify the FCA of its wish to obtain an interim permission and pay a fee of £350. We consider that the interim permission fee could have a significantly different impact on industrial and provident societies, as their business model, volume of lending and turnover can be very different compared to some other categories of authorised persons (such as major bank lenders).
16. In a number of ways, the requirements found in PRIN and SYSC are reflected in the fitness test under the current CCA licensing regime. Industrial and provident societies are not 'common platform' firms, so many of the SYSC provisions apply as guidance rather than rules. As mentioned, SYSC recognises that systems and controls should be proportionate to the nature, scale and complexity of the firm's activities. If an industrial and provident society is currently regulated by the FSA because it is authorised to conduct financial services business under FSMA, it should already be familiar with GEN, SYSC and PRIN. We expect that the application of the rules in GEN, SYSC and PRIN, and on disclosure of interim permission status, to credit activity by industrial and provident societies will result in some changes to societies' procedures, and therefore incremental costs (in excess of firms already familiar with our high-level rules). We do not consider that the impact of these

rules on industrial and provident societies will be significantly different to their impact on other authorised persons.

Friendly societies

17. Sections 5 and 7 of the Friendly Societies Act 1992 sets out the framework for permissible purposes allowing incorporated societies to be registered under the Act and that any activity must be funded by voluntary subscriptions from members of the society. Schedule 5 of the Friendly Societies Act 1992 sets out the restrictions on the capacity of an incorporated friendly society to make a loan. Some friendly societies are registered under section 7(1)(a) of the Friendly Societies Act 1974. Some friendly societies do not carry on activities that are regulated by the FSA under FSMA.
18. Friendly societies that offer financial services are already regulated by the FSA, and will therefore be familiar with PRIN, GEN and SYSC. We expect that the application of these rules, and rules relating to their interim permission status, to consumer credit business will inevitably incur some costs; however, we expect these to be low. We do not consider that the impact of these rules on friendly societies will be significantly different to their impact on other authorised persons.
19. Friendly societies that have OFT licences and wish to continue to carry on consumer credit activity following the transfer will be required to notify the FCA of their wish to obtain an interim permission and pay a fee of £350. We consider that the interim permission fee could have a significantly different impact on friendly societies, as their business model, volume of lending and turnover can be very different compared to some other categories of authorised persons (such as major bank lenders).

EEA mutual societies

20. For these purposes, EEA mutual societies are defined as:
 - a) A body which is a European Cooperative Society for the purposes of Council Regulation (EC) No 1435/2003 (statute for a European Cooperative Society);
 - b) A body which is established as a cooperative under the law of an EEA state as mentioned in that Regulation.
 - c) A body which is a cooperative or mutual undertaking of such description as the Treasury specify by order and which is established or operates in accordance with the laws of an EEA state.
21. There are currently no UK registered European Co-operative Societies.
22. We do not expect our proposed rules to result in a significantly different impact on EEA mutual societies than on other authorised persons.

Annex 7

Second charge loans

Introduction

1. Second charge loans are currently regulated alongside other forms of consumer credit in the CCA regime. The Government announced its intention to transfer the regulation of second charge loans to the FCA in January 2011, but the timing of the transfer has been dependent on the wider transfer of consumer credit to the FCA and the implementation of the proposed Mortgage Credit Directive¹ ('the Directive') (which is likely to impose regulatory requirements on both first and second charge lending).

What is a second charge loan?

2. A second charge loan is a loan that is secured on a customer's property where that customer already has a 'first charge mortgage'. The first charge mortgage usually secures the loan that the customer has to purchase their property over a number of years. A second charge loan is a further loan that is granted to the customer, usually by a different lender, which is also secured on the property.
3. When we speak about second charge loans, we are talking about both second charge lending and any subsequent charge loans on the property (e.g. third charge, fourth charge etc). Because the additional loan is secured by the 'second charge' on the property, the lender will only recover their money in a repossession action after the 'first charge' has been fully paid. The order of the charge (e.g. first, second) reflects the order in which the lenders will be paid from the proceeds of the sale of the property.

Our proposals

4. The Government is proposing that regulatory responsibility for second charge lending transfers to the FCA alongside other forms of consumer credit in April 2014, and that it should be treated in broadly the same manner as other forms of consumer credit lending.

¹ http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm#directive



Once the Directive has been finalised, there will be further consultation from the Government and the FCA on the longer term regulatory treatment of second charge lending.

5. The initial transfer process and the requirements that will apply for second charge lending from April 2014 will be largely the same as those that will apply for other types of consumer credit lending. Existing firms with an OFT standard licence will need to notify the FCA of their desire to have an interim permission in order to continue second charge business from April 2014. New firms entering the market after 31 March 2014 will be required to seek a full consumer credit permission, as with other consumer credit firms.
6. As there might be further changes for second charge lending after the Directive is implemented, we have considered how we can manage burdens on firms. We do not currently propose to direct existing second charge lending firms to seek a full consumer credit permission. Where firms have an interim permission that covers both second charge lending and another form of consumer credit lending, and they gain full authorisation for the other form of consumer credit lending, the Government proposes that they should be allowed to retain the interim permission for their second charge lending. This means that the additional requirements that apply to firms in the full consumer credit regime (for example, reporting requirements) would not apply to the firm's second charge lending business.
7. When designing the longer term regime for second charge loans, the FCA will also consider how the transition process can be smoothed for those new entrant firms who will have gained a full consumer credit permission for their second charge lending.

Summary of our proposals

- Regulation of second charge loans will transfer to the FCA on 1 April 2014 and will be treated in a similar manner to other forms of consumer credit lending.
- Existing firms will need to have an interim permission to continue that business from April 2014.

Q30: Do you have any comments regarding our proposed approach to second charge lending?

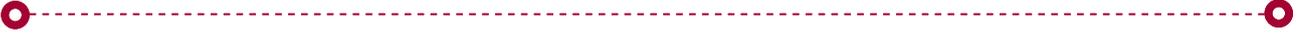
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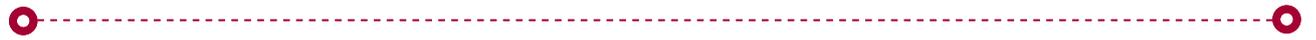
Overview of the future legal structure

	Authorisation		Standards			Redress	Enforcement
	Interim	Full	Prudential	Conduct			
Financial Services and Markets Act 2000 http://www.legislation.gov.uk/ukpga/2000/8/contents	Firms obtain interim permission after notification to FSA. Once interim permission becomes effective, FSMA applies with modifications set out in the Regulated Activities Order until full permission (or Variation of Permission) obtained.	Full FSMA regime – includes provisions relating to regulated and prohibited activities, permission to carry on activities, control of business transfers and other provisions relating to control of authorised persons etc.	Rule making powers.	Rule making powers.		Financial Ombudsman Service, consumer redress schemes.	Usual enforcement powers, such as power to fine and new powers on product intervention and financial promotions.
FSMA Statutory Instruments	Regulated Activities Order and Regulated Activities (Amendment) Order, which amongst other things set out the requirements of the interim permission regime.	Regulated Activities Order, Threshold Conditions Order, Appointed Representatives Regulations etc.	Threshold Conditions Order.	Financial Promotions Order.			
FCA Handbook http://fsahandbook.info/FSA/index.jsp	FCA Handbook including PRIN, Interim Rules and FEES.	FCA Handbook including AUTH, COND, APER, FIT, FEES, and new consumer credit conduct of business rules.	FCA Handbook including PRIN, SYSC, GEN.	FCA Handbook including consumer credit conduct of business rules and PRIN.		FCA Handbook including DISP, COMP, COAF	FCA Handbook including EG, FC.
Government proposals amending the Consumer Credit Act 1974						Some protections retained including those covering form and contents of agreements, signing of agreements, variation of agreements, and all provisions in Part VII default and termination (except 86A).	Some criminal sanctions retained. For example, if a credit reference agency fails to meet its disclosure obligations (s.158).
CCA Statutory Instruments						DISP.	

FCA Handbook – Acronyms

FEES	Fees Manual
FIT	The Fit and Proper test for Approved Persons
COND	Threshold Conditions (COND)
APER	Statements of Principle and Code of Practice for Approved Persons (APER)
PRIN	Principles for Businesses (PRIN)
SYSC	Senior Management Arrangements, Systems and Controls (SYSC)
GEN	General Provisions (GEN)
DISP	Dispute Resolution: Complaints (DISP)
COMP	Compensation (COMP) – the rules governing eligibility under, and levies for, the Financial Services Compensation Scheme
COAF	Complaints against the FSA (COAF)
EG	The Enforcement Guide (EG)
DEPP	Decision Procedure and Penalties manual
FC	Financial Crime: a guide for firms (FC)





Appendix 1

Draft Handbook text

**CONSUMER CREDIT (HIGH-LEVEL STANDARDS AND INTERIM REGIME)
INSTRUMENT 2013**

Powers exercised by the Financial Conduct Authority

- A. The Financial Conduct Authority makes this instrument in the exercise of the powers and related provisions in the following sections of the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (FCA’s general rule-making power);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (FCA’s power to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Powers exercised by the Prudential Regulation Authority

- C. The Prudential Regulation Authority makes this instrument in the exercise of the powers and related provisions in the following sections of the Act
- (1) section 137G (PRA’s general rule-making power); and
 - (2) section 137T (General supplementary powers).
- D. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- E. This instrument comes into force on [].

Amendments to the Handbook

- F. The modules of the FCA’s and PRA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Principles for businesses (PRIN)	Annex B
General provisions (GEN)	Annex C
Senior Management Arrangements, Systems and Controls Sourcebook (SYSC)	Annex D

- G. Where an Annex indicates:

- (1) 'FCA' beside a rule or guidance or in relation to the tables in Annex D or in relation to the Schedule to Annex E, it is made by the board of the Financial Conduct Authority;
- (2) 'FCA/PRA' beside a rule or guidance, or in relation to the definitions to be inserted in the Glossary or in relation to the Schedule to Annex E, it is made by both the board of the Financial Conduct Authority and the board of the Prudential Regulation Authority; and
- (3) 'PRA' beside a rule or guidance, it is made by the board of the Prudential Regulation Authority.

H. Annex E to this Instrument includes new Handbook rules and guidance which apply to authorised persons with interim permission for regulated activities concerning consumer credit.

Citation

- I. This instrument may be cited as the Consumer Credit (High-level Standards and Interim Regime) Instrument 2013.
- J. The rules and guidance in Annex E may be cited as the Rules and guidance for Interim Permitted Credit-Related Regulated Activities.

By order of the Board of the Financial Conduct Authority
[] 2013

By order of the Board of the Prudential Regulation Authority
[] 2013

Annex A

Amendments to the Glossary of definitions [FCA/PRA]

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

<i>authorised credit firm</i>	a <i>firm</i> authorised by the <i>FCA</i> or the <i>PRA</i> to carry on a <i>credit-related regulated activity</i> .
<i>borrower</i>	a <i>person</i> who receives credit under a <i>credit agreement</i> or a <i>person</i> to whom the rights and duties under a <i>credit agreement</i> have passed by assignment or operation of law.
<i>Consumer Credit Directive</i>	Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC.
<i>consumer hire agreement</i>	an agreement between a <i>person</i> (“the owner”) with an <i>individual</i> (“the hirer”) for the bailment or, in Scotland, the hiring, of goods to the hirer which: <ul style="list-style-type: none"> (a) is not a <i>hire-purchase agreement</i>; (b) is capable of subsisting for more than three months.
<i>credit agreement</i>	an agreement between an <i>individual</i> (“the borrower”) and any other <i>person</i> (“the lender”) by which the lender provides the borrower with credit of any amount.
<i>credit broking</i>	a <i>regulated activity</i> of the kind specified in article 36A of the <i>Regulated Activities Order</i> .
<i>credit information agency</i>	a <i>person</i> who carries on the activities <i>by way of business</i> of <i>credit broking</i> , <i>debt adjusting</i> , <i>debt administration</i> , <i>debt counselling</i> , <i>debt collecting</i> , a <i>lender</i> (subject to exclusions specified in the <i>Regulated Activities Order</i>), or an <i>owner</i> (subject to the exclusions referred to in the <i>Regulated Activities Order</i>) or <i>providing credit references</i> .
<i>credit reference agency</i>	a <i>person providing credit references</i> .
<i>credit repair firm</i>	a <i>firm</i> which carries on the activity of <i>providing credit information services</i> with a view to securing, or advising on, the correction of, omission of anything from or making of any modification of information relevant to financial standing of an <i>individual</i> held by a <i>credit information</i>

agency or to securing that the agency stops holding the information or does not provide it to another *person*.

credit-related regulated activity (in accordance with section 22 of the *Act* (The classes of activity and categories of investments)) any of the following activities specified in Part II of the *Regulated Activities Order* (Specified Activities):

- (a) *entering into a regulated credit agreement as lender* (article 60B(1));
- (b) *exercising, or having the right to exercise rights and duties under a regulated credit agreement* (article 60B(2));
- (c) *credit broking* (article 36A);
- (d) *debt adjusting* (article 39D(1) and (2));
- (e) *debt counselling* (article 39E(1) and (2));
- (f) *debt collecting* (article 39F(1) and (2));
- (g) *debt administration* (article 39G(1) and (2));
- (h) *entering into a regulated consumer hire agreement as owner* (article 60N(1));
- (i) *exercising, or having the right to exercise rights and duties under a regulated consumer hire agreement* (article 60N(2));
- (j) *providing credit information services* (article 89A);
- (k) *providing credit references* (article 89B);
- (l) *operating an electronic system in relation to lending* (article 36G);

which is carried on by way of business and relates to a *specified investment* applicable to that activity or, in the case of (k) and (l), relates to information about a *person's* financial standing.

debt adjusting a *regulated activity* of the kind specified in article 39D of the *Regulated Activities Order*.

debt administration a *regulated activity* of the kind specified in article 39G of the *Regulated Activities Order*.

debt collecting a *regulated activity* of the kind specified in article 39F of the *Regulated Activities Order*.

debt counselling a *regulated activity* of the kind specified in article 39E of the *Regulated Activities Order*.

debt management (a) a *firm* which carries on the activities of *debt counselling* or *debt adjusting*, alone or together, with a view to an *individual* entering

<i>firm</i>	<p>into a particular debt solution; or</p> <p>(b) a <i>firm</i> which carries on the activity of <i>debt counselling</i> with that aim in view where an <i>associate</i> carries on <i>debt adjusting</i>; or</p> <p>(c) a <i>firm</i> which carries on <i>debt adjusting</i> with that aim in view where an <i>associate</i> carries on <i>debt counselling</i>; and</p> <p>in each case, other than a <i>not for profit debt advice body</i>.</p>
<i>entering into a regulated credit agreement</i>	the <i>regulated activity</i> specified in article 60B(1) of the <i>Regulated Activities Order</i> .
<i>entering into a regulated consumer hire agreement</i>	the <i>regulated activity</i> specified in article 60N(1) of the <i>Regulated Activities Order</i> .
<i>exercising, or having the right to exercise, rights and duties under a regulated credit agreement</i>	the <i>regulated activity</i> specified in article 60B(2) of the <i>Regulated Activities Order</i> .
<i>exercising, or having the right to exercise, rights and duties under a regulated consumer hire agreement</i>	the <i>regulated activity</i> specified in article 60N(2) of the <i>Regulated Activities Order</i> .
<i>hire-purchase agreement</i>	as defined in article 60L of the <i>Regulated Activities Order</i> .
<i>individual</i>	in relation to a <i>credit-related regulated activity</i> , a natural <i>person</i> or a <i>partnership</i> consisting of two or three <i>persons</i> not all of whom are <i>bodies corporate</i> or an unincorporated body of <i>persons</i> which does not consist entirely of <i>bodies corporate</i> and is not a <i>partnership</i> .
<i>lender</i>	the <i>person</i> providing credit under a <i>credit agreement</i> ; or a <i>person</i> who exercises or has the right to exercise the rights and duties of a <i>person</i> who provided credit under such an agreement, as defined in article 60L of the <i>Regulated Activities Order</i> .
<i>limited permission</i>	a Part 4A permission for a relevant credit activity as defined in paragraph 2A(4) of Schedule 6 to the <i>Act</i> .

<i>not for profit body</i>	a body which, by or by virtue of its constitution or any enactment:
	(a) is required (after payment of outgoings) to apply the whole of its income, and any capital which it expends, for charitable or public purposes, and
	(b) is prohibited from directly or indirectly distributing amongst its members any part of its assets (otherwise than for charitable or public purposes).
<i>not for profit debt advice body</i>	a body which is a <i>not for profit body</i> with a <i>limited permission</i> to carry on <i>debt counselling</i> alone or together with either or both <i>debt adjusting</i> and <i>providing credit information services</i> , where no <i>associate</i> (other than a <i>not for profit debt advice body</i>) of the body carries on <i>debt adjusting</i> or <i>debt counselling</i> or <i>providing credit information services</i> .
<i>operating an electronic system in relation to lending</i>	a <i>regulated activity</i> of the kind specified in article 36G of the <i>Regulated Activities Order</i> .
<i>providing credit information services</i>	a <i>regulated activity</i> of the kind specified in article 89A of the <i>Regulated Activities Order</i> .
<i>providing credit references</i>	the <i>regulated activity</i> specified in article 89B of the <i>Regulated Activities Order</i> .
<i>regulated consumer hire agreement</i>	as defined in article 60N(3) of the <i>Regulated Activities Order</i> .
<i>regulated credit agreement</i>	as defined in article 60L of the <i>Regulated Activities Order</i> .
<i>relevant agreement</i>	as defined in article 36G(4) of the <i>Regulated Activities Order</i> .

Amend the following definitions as shown.

<i>associate</i>	(1)	...
	(2)	...
	(2A)	<u>(in relation to a <i>credit-related regulated activity</i>), as defined in article 60L (interpretation) of the <i>Regulated Activities Order</i>.</u>

in relation to a *person* ("P"):

- (a) where P is an individual any *person* who is or who has been:
 - (i) P's spouse or P's civil partner;
 - (ii) a relative of P, P's spouse or P's civil partner;
 - (iii) the spouse or civil partner of a relative of P or P's spouse or civil partner;
 - (iv) If P is a member of a *partnership*, any of P's *partners* and the spouse or civil partner of any such *person*;
- (b) where P is a *body corporate*:
 - (i) any *person* who is a *controller* ("C") of P;
 - (ii) any other *person* for whom C is a *controller*.

(3) (except in *LR* or in relation to a *credit-related regulated activity*) (in relation to a *person* ("A")):

- (a) an *affiliated company* of A;
- (b) an *appointed representative* of A, or a *tied agent* of A, or of any *affiliated company* of A;
- (c) any other *person* whose business or domestic relationship with A or his *associate* might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties.

client

(1) (except in *PROF*, except in relation to a *credit-related regulated activity* and except in relation to a *home finance transaction*) has the meaning given in *COBS* 3.2, that is (in summary and without prejudice to the detailed effect of *COBS* 3.2) a *person* to whom a *firm* provides, intends to provide or has provided a service in the course of carrying on a *regulated activity*, or in the case of *MiFID* or *equivalent third country business*, an *ancillary service*;

- (a) every client is a *customer* or an *eligible counterparty*;
- (b) "client" includes:
 - (i) a potential client;
 - (ii) a client of an *appointed representative* of a *firm*

with or for whom the *appointed representative* acts or intends to act in the course of business for which the *firm* has accepted responsibility under section 39 of the *Act* (Exemption of appointed representatives) or, where applicable, a client of a *tied agent* of a *firm*;

- (iii) a *collective investment scheme* even if it does not have separate legal personality;
- (iiiA) any *person* to whom *collective portfolio management* services are provided, irrespective of whether or not it is *authorised*;
- (iv) if a *person* ("C1"), with or for whom the *firm* is conducting or intends to conduct *designated investment business*, is acting as agent for another *person* ("C2"), either C1 or C2 in accordance with the *rule* on agent as client COBS 2.4.3R;
- (v) for a *firm* that is *establishing, operating or winding up a personal pension scheme*, a member or beneficiary of that scheme;

(c) "client" does not include:

- (i) a trust beneficiary not in (b)(v);
- (ii) a *corporate finance contact*;
- (iii) a *venture capital contact*.

...

(9) (in relation to a *credit-related regulated activity*) a *customer*.

controller

...

(2A) (in relation to a *firm* ("B") which has a *limited permission*, but does not carry on any other *regulated activities*) a *person* ("A") who (whether acting alone or in concert):

- (a) holds 33% or more of the *shares* in B or in a *parent undertaking* ("P") of B;
- (b) holds 33% or more of the *voting power* in B or P; or
- (c) holds *shares* or *voting power* in B or P as a result of which A is able to exercise significant influence over the management of B.

customer

- ...
- (1) (except in relation to *ICOBS*, a credit-related regulated activity, *MCOB 3* and *CASS 5*) a *client* who is not an *eligible counterparty* for the relevant purposes.
- ...
- (5) (in relation to a credit-related regulated activity) an *individual* who enters, intends to enter or has entered into a credit agreement or a consumer hire agreement; and:
- (a) (in relation to credit broking) an *individual*, who the *firm* introduces under article 36A(a), (b) or (c) of the Regulated Activities Order, to whom the *firm* presents or offers a credit agreement under article 36A(d) of that Order, who the *firm* assists under article 36A(e) of that Order or with whom the *firm* enters into a credit agreement on behalf of the *lender* under article 36A(f) of that Order;
- (b) (in relation to operating an electronic system in relation to lending) an *individual* who enters, intends to enter or has entered into a credit agreement as borrower, or a person who enters, intends to enter or has entered into a relevant agreement as lender, but does not as a result carry on a regulated activity;
- (c) (in relation to debt adjusting) the *borrower* for whom the *firm* acts in carrying on that regulated activity under a credit agreement or the *hirer* for whom the *firm* acts in carrying on that regulated activity under a consumer hire agreement;
- (d) (in relation to debt counselling) a *borrower* to whom the *firm* gives advice about the liquidation of a debt due under a credit agreement or a *hirer* to whom the *firm* gives advice about the liquidation of a debt due under a consumer hire agreement;
- (e) (in relation to debt collecting) an *individual* (including an *individual* providing a guarantee or indemnity under the regulated credit agreement) from whom the payment of a debt is sought (whether or not that *individual* is a party to the credit agreement);
- (f) (in relation to debt administration) an *individual* (including an *individual* providing a guarantee or indemnity under the regulated credit agreement) in relation to whom the *firm* has sought to perform duties or exercise or enforce rights under a credit agreement

on behalf of the lender or under a consumer hire agreement on behalf of the owner;

(g) (in relation to providing credit information services) an individual for whom the steps referred to in that regulated activity are taken or an individual to whom advice about taking any of those steps is given; and

(h) (in relation to providing credit references) an individual about whom information relevant to his financial standing is or was held by a credit reference agency.

owner

(1) (in RCB) ...

(2) (in relation to a credit-related regulated activity), as defined in article 60N(3) of the Regulated Activities Order:

(a) the person who hires goods under a regulated consumer hire agreement; or

(b) a person who exercises or has the right to exercise the rights and duties of a person who hired goods under such an agreement.

retail client

(1) (other than in relation to the provision of basic advice on stakeholder products or to credit-related regulated activities) in accordance with COBS 3.4.1R, a client who is neither a professional client or an eligible counterparty; or

[Note: article 4(1)(12) of MiFID]

(2) (in relation to the provision of basic advice on a stakeholder product and in accordance with article 52B of the RAO) any person who is advised by a firm on the merits of opening or buying a stakeholder product where the advice is given in the course of a business carried on by that firm and it is received by a person not acting in the course of a business carried on by him; or

(3) (in relation to credit-related regulated activities) a customer.

Annex B

Amendments to the Principles for Businesses (PRIN)

In this Annex, underlining indicates new text.

Approach to client categorisation

1.2.2 G *Principles 6, 8 and 9 and parts of Principle 7, as qualified by PRIN 3.4.1R, apply only in relation to customers (that is, clients which are not eligible counterparties). The approach that a firm (other than for credit-related regulated activities in relation to which client categorisation does not apply) needs to take regarding categorisation of clients into customers and eligible counterparties will depend on whether the firm is carrying on designated investment business or other activities, as described in PRIN 1.2.3G and PRIN 1.2.4G.*

[FCA]

1.2.3 G (1) ...

[FCA] (1A) Client categorisation under COBS 3 or PRIN 1 Annex 1R is not relevant to credit-related regulated activities and accordingly the guidance on the approach to client categorisation does not apply in relation to a credit-related regulated activity. The definitions of client and customer in relation to those regulated activities reflect the meaning of “individual” and the definition of “relevant recipient of credit” in the Regulated Activities Order.

(2) ...

3.1 Who?

...

3.1.8 G The *Principles* will not apply to the extent that they purport to impose an obligation which is inconsistent with the *Payment Services Directive*, *Consumer Credit Directive* or the *Electronic Money Directive*. For example, there may be circumstances in which *Principle 6* may be limited by the harmonised conduct of business obligations applied by the *Payment Services Directive* and *Electronic Money Directive* to credit institutions (see Parts 5 and 6 of the *Payment Services Regulations* and Part 5 of the *Electronic Money Regulations*) or applied by the *Consumer Credit Directive* (see for example the information requirements in the *Consumer Credit (Disclosure of Information) Regulations 2010 (S.I. 2010/1013)*).

[FCA]

3.2 What?

3.2.1 R *PRIN* applies with respect to the carrying on of:

[FCA/ PRA]	(1)	<i>regulated activities</i> ;
	(2)	activities that constitute <i>dealing in investments</i> as principal, disregarding the exclusion in article 15 of the <i>Regulated Activities Order</i> (Absence of holding out etc); and
	(3)	<i>ancillary activities</i> in relation to <i>designated investment business</i> , <i>home finance activity</i> , <u><i>credit-related regulated activity</i></u> , <i>insurance mediation activity</i> and <i>accepting deposits</i> .
3.2.2A [FCA]	R	<u><i>PRIN 1 Annex 1R, PRIN 3.4.1R and PRIN 3.4.2R do not apply with respect to the carrying on of credit-related regulated activities.</i></u>
...		
3.4	General	
3.4.3 [FCA]	G	(1) ...
		(2) ...
		<u><i>PRIN 3.4.1R and PRIN 3.4.2R do not apply with respect to the carrying on of credit-related regulated activities. Client categorisation does not apply in relation to carrying on a credit-related regulated activity. The definitions of client and customer in relation to those regulated activities reflect the meaning of “individual” and the definition of “relevant recipient of credit” in the Regulated Activities Order.</i></u>
...		

Annex C

Amendments to the General Provisions (GEN)

In this Annex, underlining indicates new text and striking through indicates deleted text, and double underlining and double striking through indicates changes which are to be made by other instruments not yet in force.

1.2 Referring to approval by the appropriate regulator

...

1.2.2 R ...

[FCA]

- (2) Paragraph (1) does not apply to statements that explain, in a way that is fair, clear and not misleading, that:
- (a) the *firm* is an *authorised person*;
 - (aa) the *firm* has a *limited permission*;
 - (b) the *firm* has *permission* to carry on a specified activity;
 - (c) an *authorisation order* has been made in relation to an *AUT* or *ICVC*;
 - (d) a *recognised scheme* has the status;
 - (e) the *firm's approved persons* have been approved by the ~~FS4~~ appropriate regulator for the purposes of section 59 of the *Act* (Approval for a particular arrangements);
 - (f) the *firm* has been given express written approval by the ~~FS4~~ appropriate regulator in respect of a specific aspect of the *firm's* affairs.

...

- (4) Where a *firm* with a *limited permission* refers to its *permission* in a public statement or in relation to a *client*, it must explain in a fair, clear and not misleading way that the *permission* was granted under the *limited permission* procedure.

4 Statutory status disclosure

...

4.2 Purpose

...

4.2.2 G There are other pre-contract information requirements outside this chapter,
[FCA] including:

...

- (6) for *equity release transactions*, initial disclosure requirements in *MCOB 8.4*, pre-application disclosure requirements in *MCOB 9.4* and disclosure at the offer stage in *MCOB 9.5*; ~~and~~
- (7) for *regulated sale and rent back agreements*, initial disclosure requirements in *MCOB 4.11*, pre-sale disclosure requirements in *MCOB 5.9* and disclosure at the offer stage requirements in *MCOB 6.9*; and
- (8) for *regulated credit agreements*, the pre-contract information requirements in the Consumer Credit (Disclosure of Information) Regulations 2010 (S.I. 2010/1013) and in the Consumer Credit (Disclosure of Information) Regulations 2004 (S.I. 2004/1481).

4.3 Letter disclosure

...

4.3.2A G For a *UK domestic firm* that is *not a PRA-authorised person* and is not a *firm*
[FCA] with *limited permission*, the required disclosure in *GEN 4 Annex 1R* is
“Authorised and regulated by the Financial Conduct Authority”.

Exception: credit firms

4.3.7 R *GEN 4.3.1R* (Disclosure in letters to retail clients) does not apply to an
[FCA/
PRA] *authorised credit firm* (other than a *firm with a limited permission*) with
respect to the activity of *entering into a regulated credit agreement* to which
the *Consumer Credit Directive* applies to the extent it would be contrary to
the UK’s obligations under an EU instrument.

4.3.8 G An *authorised credit firm* which carries on the activity of *entering into a*
[FCA/
PRA] *regulated credit agreement* to which articles 5 and 6 of the *Consumer Credit*
Directive apply is under an obligation to disclose pre-contract information in
the form and to the extent required by the *Consumer Credit Directive*.
Firms which carry on *credit broking* may take on the same obligation.

4.3.9 G *Regulated activities* covered by a *limited permission* do not fall within the
scope of Articles 5 and 6 of the *Consumer Credit Directive*, therefore *PRIN*

[FCA] 4.3.7R and the guidance related to it are not relevant to those activities.

4.3.10 G Where an *authorised credit firm* which carries on the activity of *entering into a regulated credit agreement* to which the *Consumer Credit Directive* applies is required to disclose information regarding its supervisor by regulation 8(1) of the Consumer Credit (Disclosure of Information) Regulations 2010 or regulation 11 of those Regulations or where a *firm* which carries on *credit broking* takes on the same obligation, the *firm* should use:

[FCA/
PRA]

- (1) for a *firm* which has a *Part 4A permission*, but is not a *PRA-
authorised person*, the relevant disclosure in *GEN 4 Annex 1R*; or
- (2) for a *PRA-
authorised person*, which has a *Part 4A permission*, the relevant disclosure in *GEN 4 Annex 1AR*.

**4 Annex 1R Statutory status disclosure (firms that are not PRA-
authorised persons)**

[FCA]

...

	Type of firm	Required disclosure (Note 5)
(6)	<u><i>UK domestic firm</i> which has a <i>limited permission</i>; or <i>overseas firm</i> (which is not an <i>incoming firm</i>) which has a <i>limited permission</i></u>	<u>“<i>Authorised with a limited permission and regulated by the Financial Conduct Authority</i>”</u>
...		

Annex D

**Amendments to the Senior Management Arrangements, Systems and Controls
sourcebook (SYSC)**

In this Annex underline indicates new text and striking through indicates deleted text.

1 Application and purpose

...

Annex 1 Detailed application of SYSC

...

Part 2	Application of the common platform requirements (SYSC 4 to 10)		
...			
2.10 [FCA/ PRA]	R	The provisions on record-keeping in SYSC 9 apply as set out in SYSC 1 Annex 1.2.8R, except that they only apply to the carrying on of <i>ancillary activities</i> that are performed in relation to:	
		(1)	<i>designated investment business;</i>
		(2)	<i>home finance activity; and</i>
		(3)	<i>insurance mediation activity;</i>
		(4)	<i>credit-related regulated activities.</i>
...			
<u>2.13A</u> [FCA]	R	<u>SYSC 6.3.1R, SYSC 6.3.3R, SYSC 6.3.8R and SYSC 6.3.9R only apply to a firm, with respect to carrying on a credit-related regulated activity, to which the Money Laundering Regulations also apply.</u>	
<u>2.13B</u> [FCA]	R	<u>SYSC 6.3.8R and SYSC 6.3.9R do not apply to a firm with a limited permission for entering into a regulated credit agreement as lender.</u>	
<u>2.13C</u> [FCA]	G	<u>The persons to whom the Money Laundering Regulations apply are set out in regulation 3 of the Money Laundering Regulations. The persons include credit institutions (for example, banks) and financial institutions (for example, persons who carry on regulated activities which consist of or include entering into regulated credit agreements as lender). These expressions are defined in regulation 3 of those Regulations.</u>	
...			

Part 3 Tables summarising the application of the common platform requirements to
[FCA] different types of firm

...

Provision SYSC 4	COLUMN A Application	COLUMN A+ Application ...	COLUMN B Application ...
...			
SYSC 4.4.1R	Not applicable	Not applicable	Rule applies this section only to (1) <i>(2A) an authorised credit firm which holds a limited permission (other than a not for profit debt advice body).</i> ...
...			

...

Provision SYSC 6	COLUMN A Application	COLUMN A+ Application ...	COLUMN B Application ...
...			
<u>SYSC 6.1.4BR</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Rule for debt management firms and credit repair firms.</u>
...			
SYSC 6.3.1R	Rule	Rule	Rule, for firms carrying on a credit-related regulated activity applies only where <u>Money Laundering Regulations</u> apply to

			<u>the firm.</u>
...			
SYSC 6.3.3R	Rule	Rule	<u>Rule, for firms carrying on a credit-related regulated activity applies only where Money Laundering Regulations apply to the firm.</u>
...			
SYSC 6.3.8R	Rule	Rule	<u>Rule, for firms carrying on a credit-related regulated activity applies only where Money Laundering Regulations apply to the firm. Rule does not apply to firm with a limited permission for entering into a regulated credit agreement as lender.</u>
SYSC 6.3.9R	Rule	Rule	<u>Rule, for firms carrying on a credit-related regulated activity, applies only where Money Laundering Regulations apply to the firm. Rule does not apply to firm with a limited permission for entering into a regulated credit agreement as lender.</u>
...			

...

4.4 Apportionment of responsibilities

Application

4.4.1 R This section applies to:

[FCA]

...

(2A) an authorised credit firm which holds only a limited permission (other than a not for profit debt advice body);

...

...

6.1 Compliance

...

6.1.4B R In order to enable the compliance function to discharge its responsibilities properly and independently, a debt management firm and a credit repair firm must appoint a compliance officer to be responsible for the compliance function and for any reporting as to compliance which may be made under SYSC 4.3.2R.

[FCA]

Annex E

Rules and guidance for Interim Permitted Credit-Related Regulated Activities

In this Annex, new provisions relevant to firms with interim permission for credit-related regulated activities are being introduced. All the text is new and is not underlined.

Handbook requirements for firms with interim permission for credit-related regulated activities**1 Application and purpose**

- 1.1 R These *rules* apply to an *authorised person* with an *interim permission*.
[FCA/
PRA]
- 1.2 G The purpose of these *rules* is:
[FCA]
- (1) to build upon *Principle 7* (Communications with clients) in the particular context of *authorised persons* with an *interim permission* and govern the way in which such *persons* may describe their authorisation and regulation by the *appropriate regulator*; and
 - (2) to provide that certain provisions of the *Handbook* that would otherwise apply to *persons* with an *interim permission* are not to apply.
- 1.3 G The purpose of these *rules* is to provide that certain provisions of the *Handbook* that would otherwise apply to *persons* with an *interim permission* are not to apply.
[PRA]

2 Referring to approval by the appropriate regulator

- 2.1 R (1) Unless required to do so under the *regulatory system*, a *firm* must ensure that neither it nor anyone acting on its behalf claims, in a public statement or to a *client*, expressly or by implication, that its affairs, or any aspect of them, have the approval or endorsement of the *appropriate regulator* or another competent authority.
[FCA/
PRA]
- (2) Paragraph (1) does not apply to statements that explain, in a way that is fair, clear and not misleading, that:
- (a) the *firm* is an *authorised person*;
 - (b) the *firm* has an *interim permission*;
 - (c) the *firm* has *permission* to carry on a specified activity;

- (d) the *firm* has been given express written approval by the *FCA* or the *PRA* in respect of a specific aspect of the *firm's* affairs.
- (3) Paragraph (1) applies with respect to the carrying on of both *regulated activities* and *unregulated activities*.
- (4) Where a *firm* with an *interim permission* refers to its *permission* in a public statement or in relation to a *client* it must explain in a fair, clear and not misleading way that the *permission* is an *interim permission*.

3 Guidance on disclosure of interim permission status

- 3.1 [FCA/
PRA] G These rules make special provision for *persons* with an *interim permission* in place of *GEN* 4.3, *GEN* 4 Annex 1R and *GEN* 4 Annex 1AR. For a *firm* with *permission* for one or more *regulated activities* other than a *credit-related regulated activity*, the *rules* and *guidance* in section 4 below (disclosure of interim permission status) apply only to the carrying on of *credit-related regulated activities*. The purpose is to prevent *clients* being misled about the extent to which the appropriate regulator has considered or approved the affairs of a *firm* with an *interim permission*.

4 Disclosure of interim permission status

- 4.1 [FCA/
PRA] R A *firm* with *interim permission* must take reasonable care to ensure that every letter (or electronic equivalent) which it or its *employees* send to a *retail client*, with a view to or in connection with the *firm* carrying on a *credit-related regulated activity*, includes the disclosure in 4.2R (*firms* that have *interim permission* only) or 4.3R (*firms* that have *interim permission* which are not *PRA-authorised firms* and who are authorised to carry on a *regulated activity* other than a *credit-related regulated activity*) or 4.4R (*firms* that have *interim permission* which are *PRA-authorised firms*).
- 4.2 [FCA] R This *rule* sets out the relevant disclosure for a *UK domestic firm* which only has an *interim permission* or for an *overseas firm* (which is not an *incoming firm*) which only has an *interim permission*:
“Regulated by the Financial Conduct Authority with an interim permission for certain credit-related regulated activities”.
- 4.3 [FCA] R This *rule* sets out the relevant disclosure for:
- (1) a *UK domestic firm*, which is not a *PRA-authorised person*, with an *interim permission* and which is authorised to carry on a *regulated activity* other than a *credit-related regulated activity*; or for an *overseas firm* (which is not an *incoming firm* and is not a *PRA-authorised person*) which has an *interim permission* and which is authorised to carry on a *regulated activity* other than a *credit-related*

regulated activity:

“Authorised and regulated by the Financial Conduct Authority also with an interim permission for certain credit-related regulated activities”.

- (2) an *incoming firm* with a *top-up permission* for a *credit-related regulated activity*, which is not a *PRA-authorised person*:

“Authorised by [name of Home State regulator] and authorised with an interim permission for certain credit-related regulated activities and subject to regulation by the Financial Conduct Authority. Details about the extent of regulation by the Financial Conduct Authority are available on request.”

- 4.4 R This rule sets out the relevant disclosure for a *UK domestic firm* which is a
[PRA] *PRA authorised person* with an *interim permission*:

“Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulatory Authority also with an interim permission for certain credit-related regulated activities”.

Exception: credit firms

- 4.5 R Paragraph 4.1R (disclosure in letters to retail clients) does not apply to a
[FCA/
PRA] *firm* with an *interim permission* with respect to the activity of *entering into a regulated credit agreement* to which the *Consumer Credit Directive* applies to the extent it would be contrary to the *UK’s* obligations under an EU instrument.

- 4.6 G A *firm* which carries on the activity of *entering into a regulated credit*
[FCA/
PRA] *agreement* to which articles 5 and 6 of the *Consumer Credit Directive* apply is under an obligation to disclose pre-contract information in the form and to the extent required by regulation 8(1) of the Consumer Credit (Disclosure of Information) Regulations 2010 or in accordance with regulation 11 of those regulations which implements the *Consumer Credit Directive*. *Firms* which carry on *credit broking* may take on the same obligation in certain cases.

- 4.7 G Where a *firm* which carries on the activity of *entering into a regulated credit*
[FCA/
PRA] *agreement* to which the *Consumer Credit Directive* applies is required to disclose information regarding its supervisor by regulation 8(1) of the Consumer Credit (Disclosure of Information) Regulations 2010 or regulation 11 of those Regulations or where a *firm* which carries on *credit broking* takes on the same obligation, the *firm* should use:

- (1) for a *UK domestic firm* which only has an *interim permission*, or for an *overseas firm* (which is not an *incoming firm*) which only has an *interim permission*, the disclosure:

“Regulated by the Financial Conduct Authority with an interim permission for certain credit-related regulated activities”; or

- (2) for a *UK domestic firm* which is not a *PRA-authorised person*, with

an *interim permission* and which is authorised to carry on a *regulated activity* other than a *credit-related regulated activity*, the disclosure:

“Authorised and regulated by the Financial Conduct Authority also with an interim permission for certain credit-related regulated activities”.

- (3) for an *incoming firm* with a *top-up permission* for a *credit-related regulated activity* which is not a *PRA-authorised person*, the disclosure:

“Authorised by [name of Home State regulator] and with an interim permission for certain credit-related regulated activities and subject to regulation by the Financial Conduct Authority. Details about the extent of regulation by the Financial Conduct Authority are available on request.”

- (4) for a *UK domestic firm* which is a *PRA-authorised person* with an *interim permission*, the disclosure:

“Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulatory Authority also with an interim permission for certain credit-related regulated activities”.

5 Disapplication of certain modules or provisions of the Handbook

- 5.1 R The modules or parts of the modules of the *appropriate regulator’s Handbook of rules* and guidance listed in the Schedule to this chapter do not apply to an *authorised person* with an *interim permission* with respect to the carrying on of a *credit related regulated activity*.
- [FCA/
PRA]

6 Interpretation

- 6.1 R In these rules the expression “interim permission” means a permission which a *person* is to be treated as having under article 23(7)(a) or (b) of the Financial Services and Markets Act 2000 (Regulated Activities)(Amendment) Order 2013.
- [FCA/
PRA]

Schedule

Modules or parts of modules of the *appropriate regulator's Handbook of rules and guidance* that are being disapplied in relation to *credit-related regulated activities* for *firms* with an *interim permission*.

Module	Disapplication or modification
General provisions (<i>GEN</i>) [FCA/PRA]	<p><i>GEN</i> 1.2.2R (referring to approval by the appropriate regulator) and <i>GEN</i> 4.3 (letter disclosure) do not apply:</p> <p>(1) to a <i>person</i> who only has an <i>interim permission</i>; or</p> <p>(2) to carrying on <i>credit-related regulated activities</i> by a <i>firm</i> which has an <i>interim permission</i> and <i>permission</i> to carry on another <i>regulated activity</i>.</p>
Senior Management Arrangements, Systems and Control sourcebook (<i>SYSC</i>) [FCA]	<p><i>SYSC</i> 6.1.4BR (requirement of debt management firm or credit repair firm to appoint a compliance officer) does not apply to a <i>firm</i> with an <i>interim permission</i>.</p> <p><i>SYSC</i> 6.3.8R (responsibility for anti-money laundering systems and controls) does not apply to a <i>firm</i> with only an <i>interim permission</i>.</p> <p><i>SYSC</i> 6.3.9R (requirement to appoint a money laundering reporting officer) does not apply to a <i>firm</i> with only an <i>interim permission</i>.</p>
Fees manual (<i>FEES</i>) [FCA]	<p>The Fees manual does not apply in respect of the fee provided for in <i>FEES</i> 8.1.1R(1), except for the rules in <i>FEES</i> 8.1.</p>

FEES (CONSUMER CREDIT INTERIM PERMISSION) INSTRUMENT 2013

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137T (General supplementary powers); and
 - (2) paragraph 23(1) (Fees) of Schedule 1ZA (The Financial Conduct Authority).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on *[date]*.

Amendments to the Handbook

- D. The Fees manual (FEES) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Fees (Consumer Credit Interim Permission) Instrument 2013.

By order of the Board
[date]

Annex

Amendments to the Fees manual (FEES)

In this Annex, the text is all new and is not underlined.

After FEES 7 insert the following new section.

8 Interim Fees

8.1 Consumer Credit permissions

- 8.1.1 R (1) A *person* who notifies the *FCA* of a desire to obtain interim permission under Article [X] (Interim permission) of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013 must pay to the *FCA*, in full and without deduction, a fee of :
- (a) where the *person* is a sole trader, £150;
 - (b) in any other case, £350.
- (2) Paragraph (1) does not apply if, immediately before 1 April 2014, the *person* held a standard licence under the Consumer Credit Act 1974 which covered only the carrying on of:
- (a) non-commercial debt counselling; or
 - (b) non-commercial debt counselling and non-commercial debt adjusting; or
 - (c) non-commercial debt counselling and non-commercial credit information services (including non-commercial credit repair); or
 - (d) non-commercial debt counselling, non-commercial debt adjusting and non-commercial credit information services (including non-commercial credit repair);
- and which did not cover any other description or type of business.
- (3) The fee required by (1) must be paid via the online system used to notify the *FCA* of the *person's* desire to obtain interim permission and must be paid by debit card (Maestro/Visa only) or credit card (Visa/Mastercard only).
- (4) The fee required by (1) must be paid when the *person* notifies the *FCA* of a desire to obtain interim permission.
- (5) This *rule* applies from [X] 2013 until 31 March 2014.

- 8.1.2 R (1) The Fees manual does not apply in respect of the fee provided for in *FEES* 8.1.1R(1), except for the rules in *FEES* 8.1.
- (2) This *rule* applies from [X] 2013 until the date the *person* applies for a *Part 4A permission* or a variation of *permission* with respect to the activities previously covered by the *person's* interim permission.

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