

# Detailed proposals for the FCA regime for consumer credit

Including feedback to FSA CP13/7 and the policy statement  
on high-level rules that we consulted on in FSA CP13/7\*\*\*

October 2013





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We are asking for comments on this Consultation Paper by 3 December 2013. You can send them to us using the form on our website at: [www.fca.org.uk/your-fca/documents/consultation-papers/cp13-10-response-form](http://www.fca.org.uk/your-fca/documents/consultation-papers/cp13-10-response-form)

**Or in writing to:**

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Consumer Credit  
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25 The North Colonnade  
Canary Wharf  
London E14 5HS

**Telephone:** 020 7066 2000  
**Email:** [cp13-10@fca.org.uk](mailto:cp13-10@fca.org.uk)

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

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.

You can download this Consultation Paper from our website: [www.fca.org.uk](http://www.fca.org.uk). Or contact our order line for paper copies: 0845 608 2372.

## Abbreviations used in this paper

<b>APR</b>	Annual Percentage Rate
<b>APF</b>	Authorised professional firm
<b>BBA</b>	British Bankers' Association
<b>CAB</b>	Citizen's advice bureau
<b>CEO</b>	Chief Executive Officer
<b>CASS</b>	Client assets
<b>CMA</b>	Competition and Markets Authority
<b>CC</b>	Competition Commission
<b>CJ</b>	Compulsory Jurisdiction
<b>CP</b>	Consultation paper
<b>CCA</b>	Consumer Credit Act
<b>CCAR</b>	Consumer Credit Advertisement Regulations
<b>CCD</b>	Consumer Credit Directive
<b>CCJ</b>	Consumer Credit Jurisdiction
<b>CFA</b>	Consumer Finance Association
<b>CPRs</b>	Consumer Protection from Unfair Trading Regulations
<b>CPA</b>	Continuous payment authority
<b>DMP</b>	Debt management plan
<b>DPB</b>	Designated Professional Body
<b>BIS</b>	Department for Business, Innovation and Skills
<b>EE</b>	Europe Economics
<b>EPF</b>	Exempt professional firm

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<b>FCA</b>	Financial Conduct Authority
<b>FSA</b>	Financial Services Authority
<b>FSMA</b>	Financial Services and Markets Act
<b>FSCS</b>	Financial Services Compensation Scheme
<b>FSF</b>	Firm Systematic Framework
<b>HCSTC</b>	High-cost short-term credit
<b>IP</b>	Insolvency practitioner
<b>JSA</b>	Jobseeker's allowance
<b>MLAR</b>	Mortgage Lending and Administration Return
<b>OFT</b>	Office of Fair Trading
<b>PCBS</b>	Parliamentary Commission on Banking Standards
<b>PSD</b>	Product sales data
<b>PRA</b>	Prudential Regulation Authority
<b>RDC</b>	Regulatory Decisions Committee
<b>SCOR</b>	Steering Committee on Reciprocity
<b>TAR</b>	Total Amount Repayable
<b>TCC</b>	Total Cost of Credit
<b>VJ</b>	Voluntary Jurisdiction

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## Sourcebooks in our Handbook

<b>CONC</b>	Consumer credit sourcebook
<b>DEPP</b>	Decision Procedure and Penalties Manual
<b>EG</b>	Enforcement Guide
<b>GEN</b>	General Provisions
<b>PERG</b>	The Perimeter Guidance Manual
<b>PRIN</b>	Principles for Businesses
<b>SYSC</b>	Senior Management Arrangements, Systems and Controls
<b>UNFCOG</b>	Unfair Contract Terms Regulatory Guide

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## Foreword

When we launched the FCA earlier this year, I said I wanted to use our new powers to bring a more human face to regulation; a more pragmatic, sophisticated approach. In doing so, we have to ensure the right protection is in place for consumers when things go wrong while making sure there is effective competition so people have access to the financial services that they want. Nowhere will this be truer than in the consumer credit market.

Although the regulation of this market doesn't transfer to us until April 2014, we have made significant progress in getting ready. We have consulted on the framework for the regime and now made the high-level rules, opened our interim permission system for firms and initiated research into the credit market.

We are committed to creating a regime that builds on what the Office of Fair Trading (OFT) had in place, while bringing in the FCA's approach to regulation, most notably in how we supervise firms. Changes in regulation will naturally raise questions for firms, as the regime will be more stringent. In this consultation paper we set out proposed new requirements and I encourage firms, organisations, consumers and other related parties to read the consultation and let us know their thoughts.

We have put the spotlight on payday and other high-cost short-term lending because we must take action to help those consumers most at risk. Many consumer groups, and consumers themselves, have told us that payday lending can have a place; however, too many consumers get loans they can never afford to repay. Our message to any company that harms their customers – the clock is ticking.

For these reasons, in this document we are consulting on a set of interventions in the high-cost short-term credit market aimed at ensuring lenders pay more attention to responsible lending, specifically:

- The OFT affordability guidance is good, but the OFT's own research shows too few firms implement it. We will put it into our rules and guidance, and enforce this.
- We want to stop payday loans spiralling endlessly by capping the number of times they can be rolled over to two.
- Many lenders don't have the incentive to carry out robust affordability assessments because they are given unrestricted access to borrowers' accounts through 'continuous payment authorities'. We propose restricting the use of this kind of payment to two, forcing firms to make better lending decisions.
- Advertising often makes borrowing look easy, when for some paying a loan back is going to be tough. We propose applying a risk warning – a 'health warning' if you like – for payday loan adverts, and directing consumers to free, independent debt advice.

We know that these markets are evolving rapidly. This document contains our final package of proposals for April 2014. After we start regulating consumer credit, our supervision teams will consider firms' fees and charges practices to decide if we need to intervene further.

Our enforcement teams are already working with the OFT so that we can take action where existing rules aren't being followed and where we believe that firms are continuing to harm consumers.

In debt management too, we are introducing new requirements for firms to hold a minimum amount of capital and more detailed rules for the firms that hold client money. In addition we propose rules that will bring all firms in line with the sector's best practice: signposting potential customers to free debt advice' protecting consumers' money, and spreading set-up costs so that they start paying off their debts as soon as possible.

We intend to introduce as many of the new protections as soon as we can on or shortly after 1 April 2014, while allowing firms an opportunity to adjust their business models. Detailed timings are proposed in this document.

We will also be considering how competition is operating in these markets in the interests of consumers and will launch market studies where needed. We also await the Competition Commission's study of payday lending with interest.

This consultation is a significant milestone in our efforts to secure better consumer protection in the credit market and I urge you to engage with us over the next two months so that we know we have considered all options and issues when we publish our rules next year and start to regulate this market from April.

Martin Wheatley

Chief Executive

## **Part A – Consultation on detailed proposals for the FCA regime for consumer credit**

# 1.

## Executive summary

### Introduction

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- 1.1** On 1 April 2014 we will take over the regulation of the consumer credit industry from the Office of Fair Trading (OFT). We have been preparing for this since the Government announced the proposed transfer in January 2012, and in March this year the FSA consulted on our high-level proposals for our new regime.
- 1.2** In developing our consumer credit policy we have been aware of the need to consider the different requirements of the wide range of businesses affected – both the ones that are already familiar with our regulatory processes, and those that will be new to us and will need more help to understand how we will work with them once they are brought into our regime.
- 1.3** While considering this largely new population of firms, we set this in the context of our wider overall aim to enhance protection for consumers and make sure that they get a fair deal. We want consumers to have access to services and products they need, from firms they can trust.
- 1.4** We intend to make the transition for firms as straight-forward and proportionate as we can, ensuring they are regulated effectively and that those posing a higher risk to consumers are subject to enhanced supervision. This means that we will be able to deal with potential or actual problems quickly and robustly, in line with the way we supervise all regulated firms, while ensuring there is effective competition in the interests of consumers in the market.

### We are now continuing with our consultation

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- 1.5** This consultation paper is a progression from the FSA paper published in March.<sup>1</sup> As a result of the feedback we received, we have made a number of changes to the proposed approach. Part A of this consultation paper contains the detailed feedback we received and our responses, as well as details of changes we have made to our proposals and further consultation. Part B is a policy statement on the rules regarding our high-level conduct standards for firms that have now been made and will come into force on 1 April 2014.
- 1.6** The consultation period runs until 3 December 2013 – you can send us your feedback either online or by post (see page 4 for more details). You will also have the opportunity to discuss this with us at a programme of events and road shows we will be running across the country.

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<sup>1</sup> FSA CP 13/7, *High-level proposals for an FCA regime for consumer credit*.

## Key features of our proposals that apply to all firms

### Strengthened scrutiny of firms trying to enter the market (Chapter 3)

- 1.7** Our authorisation process is the gateway through which firms must pass to allow them to access the market. We will aim to ensure that all firms wanting to offer consumer credit products and services are well run, fit and proper and, where applicable, have suitable business models.
- 1.8** We will identify which firms are carrying out activities that pose a higher risk to consumers and which are carrying out lower-risk activities, and we will have a different supervisory approach depending on what category a firm falls into. This proportionate approach will help us focus our most intense scrutiny on higher-risk firms and the problems that have a greater impact on consumers, while ensuring consumers still have access to the products and services they need.

### Proactive supervision and enforcement (Chapters 4 and 12)

- 1.9** We will have dedicated supervision and enforcement teams to crack down on poor practice, money laundering and unauthorised activity, to seek out the firms that are not complying with our rules or are illegally carrying out consumer credit business.
- 1.10** Where we find that firms are not complying, we will consider using our enforcement tools, and we can require them to offer redress to their customers where necessary. In appropriate cases, disciplinary action could lead to fines. Criminal sanctions are also available, with custodial sentences for the worst offenders.

### Conduct rules and guidance (Chapter 5)

- 1.11** The current consumer credit regime comprises the standards set out in the Consumer Credit Act (CCA) and its secondary legislation as well as OFT guidance. We will be carrying across many of these standards into our own rules and guidance, which will help to protect consumers and reduce the burden on firms as they will already be familiar with OFT rules.
- 1.12** The high level principle to be clear, fair and not misleading in financial promotions is the backbone to our approach. As firms will be required to comply with our principles for businesses and the Consumer Protection from Unfair Trading Regulations, this should not impose a further burden on them.
- 1.13** Inevitably there are some differences between the current CCA regime and our proposed rules. For example, we have included key parts of the guidance published by the Department for Business on the Consumer Credit Advertisement Regulations (CCAR).

### A risk-based approach (Chapter 2)

- 1.14** We aim to create a system that ensures firms can continue to deliver the products and services that give consumers a fair deal, but where we can implement changes to improve consumer protection and enhance competition in the market.
- 1.15** We only place additional costs and burdens on firms if they are proportionate to securing an appropriate degree of protection for consumers or to promoting effective competition in the interests of consumers, keeping in mind how important it is for credit to continue to be available to help consumers manage their finances.
- 1.16** As part of this proportionate approach, as well as our transitional measures, we are also limiting how much data we will ask firms to report to us until they are authorised<sup>2</sup> and in the consumer credit market we are only proposing to require debt management firms and some not-for-profit advice bodies to hold specific amounts of capital.

<sup>2</sup> You can find our more detailed data strategy on our website.

### **Firms can register now for interim permission**

- 1.17** Since 2 September firms with OFT consumer credit licences have been able to register with us for 'interim permission', which means they can continue to carry out their consumer credit activities from 1 April 2014 until they are fully authorised. We are offering a 30% discount to firms that register before 30 November 2013.<sup>3</sup>

### **High-cost short-term credit, including payday lending (Chapter 6)**

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- 1.18** We consider that the high-cost short-term credit sector poses a potentially high risk to consumers in financial difficulty.
- 1.19** Some of the problems identified in this sector include misleading adverts that emphasise the speed and simplicity of applying for a loan, a lack of adequate affordability assessments and firms not treating customers fairly.
- 1.20** Our proposals include requiring firms in the high-cost short-term credit sector to:
- assess the potential for a loan to adversely affect the customer's financial situation
  - limit the number of times they can seek payment using a continuous payment authority
  - limit the number of times a loan can be 'rolled over'
  - inform customers about sources of debt advice before refinancing a loan
  - put risk warnings on loan adverts

### **Debt management (Chapters 7 and 9)**

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- 1.21** In the FSA paper in March we proposed to set capital requirements for debt management firms, in particular to ensure that they are covered against the risks in their business – we have now widened this to apply the requirements to some large not-for-profit debt advice firms. We now propose to require these firms to hold a certain minimum amount of capital.
- 1.22** We are also proposing to require debt management firms to spread their fees, so that consumers' money is not consumed by set-up costs in the early months of a debt management plan, but starts paying back their creditors from the beginning.

### **Future work**

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- 1.23** When our current consultation ends, we will consider all the responses we receive and publish a policy statement setting out our final rules and guidance in February or March 2014.

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<sup>3</sup> To register with us now, see our website: <https://fca-consumer-credit-interim.secure.force.com/home/home.jsp>.

- 1.24** There are many risks present in the consumer credit industry. We will continue to increase our understanding of the market and carry out significant further work, including reviews focused on particular firms, issues or products (which we call ‘thematic reviews’) and potentially market studies.
- 1.25** In 2014 we intend to publish an overview of the key features of the consumer credit sectors and the main risks and issues as part of our risk outlook and business plan. We will explain how we intend to approach these after the transfer from the OFT, including where we intend to carry out targeted pieces of work to improve our understanding of the risks and to design appropriate interventions. We will also use our analysis to improve the checks we make when firms apply to be authorised.
- 1.26** We will monitor how firms respond to the rules we introduce. We may intervene further by introducing new or tougher rules if we decide that more protection is needed to stop consumers suffering as a result of unscrupulous firms or inappropriate behaviour in the consumer credit market.

### Summary of our new proposals

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- 1.27** In this paper we are consulting on these main areas:
- How we propose to carry across the provisions of the CCA that will be repealed in April 2014 and OFT conduct standards into our rules and guidance (including the requirement for lenders to consider the potential for the commitments under a loan to adversely affect the customer’s financial situation when assessing their creditworthiness) (Chapter 5).
  - Prudential and conduct standards for debt management firms, including the minimum capital that they will have to hold and how they should separate their customers’ money from their own (Chapters 7 and 9).
  - What information and how frequently firms will have to report to us, including on complaints (Chapters 4 and 11).
  - Our approach to enforcing the retained provisions of the CCA (Chapter 5).
  - Our approach to applying to consumer credit firms our rules regarding becoming an appointed representative for a principal (Chapter 3).
  - Requirements for ‘approved persons’ (subject to the outcome of the Parliamentary Commission on Banking Standards (PCBS) recommendation) (Chapter 3).

### Who should read this paper?

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- 1.28** This consultation will interest:
- firms that currently hold individual credit licences or are covered by group licences issued by the OFT under the CCA
  - firms that are considering carrying out consumer credit activities, including debt-recovery agents

- operators of peer-to-peer platforms (which will be regulated as a specific activity from 1 April 2014) regarding protection for consumers who borrow through them<sup>4</sup>
- trade bodies representing consumer credit firms
- consumer organisations
- not-for-profit bodies providing debt counselling, debt adjusting and credit information services
- other bodies currently involved in regulating consumer credit
- 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 6)

This paper will also interest consumers.

Anyone who has taken out a loan, used a credit card, had difficulties paying back debt, or looked for advice on debt problems may want to comment on how we propose to regulate consumer credit firms.

For more information see our website

### Next steps

- 1.29** Send us your responses to the consultation questions in this paper by 3 December 2013 using the online response form on our website, or by writing to us at the address on page 4.
- 1.30** This is less than our usual three-month consultation period. We plan to make our final rules in February or March, giving firms time to familiarise themselves with them ahead of the transfer.
- 1.31** If you have any general comments not related to specific proposals please email us at: [consumercredit2@fca.org.uk](mailto:consumercredit2@fca.org.uk).

### Do you still need to register for interim permission?

Consumer credit licences from the OFT will expire on 31 March 2014.

If you currently hold a licence and you want to continue carrying out consumer credit activities from 1 April 2014, you must have registered for an interim permission from us to do so legally. See Chapter 2 for more details.

We are offering a 30% discount to firms that register for interim permission before 30 November 2013.

Register now on our website.

<sup>4</sup> We will be issuing a separate consultation paper covering the new regime for peer-to-peer platforms more generally and protections for consumers who invest through such platforms.

## 2. Implementing our new regime and registering interim permission

This chapter sets out our approach to our new consumer credit regime (including decisions made by Government which have changed the regime since March) and how this will look and feel different for consumer credit firms.

We also discuss our 'interim permissions regime', which means that firms can continue to carry out consumer credit activities from 1 April 2014 if they register with us before 1 April 2014.<sup>1</sup>

For a list of the key areas that we are consulting on in this paper, please see our executive summary.

### A smooth transition

- 2.1** The two main objectives of our regime are to protect consumers and deliver a proportionate risk-based approach to the supervision of firms. We will focus our resources on dealing with the risks that we think have the potential to cause the most harm to consumers.
- 2.2** We know our regime will be challenging for firms, particularly ones that haven't been regulated by us before, and it may potentially affect competition in the market. By helping firms understand their obligations, we aim to minimise these issues and deliver a smooth transition.
- 2.3** In particular, to help firms with the transition, our March 2013 consultation proposal:
- a two-tier approach that differentiates between higher-risk and lower-risk consumer credit activities (see Tables 2.1 – 2.2)
  - an interim permission regime which will mean that firms can take simple steps to ensure that they can continue their consumer credit activities after 1 April 2014

<sup>1</sup> A firm which is granted an OFT licence from 18 March 2014 to 31 March 2014 has a grace period of until the end of 14 April 2014 in which to register with FCA and pay its fee.

- a six-month transitional period during which, if a firm is able to demonstrate that it has acted in accordance with old CCA requirements and OFT guidance,<sup>2</sup> we will not take action against it in relation to those corresponding new rules that are substantially the same from 1 April 2014.

### What has changed since our last consultation in March 2013?

- 2.4** We have taken into account the responses we received to the FSA consultation paper. We have summarised the key points of our proposed changes in the relevant chapters in this paper – Annex 1 contains the more detailed feedback and our responses. Based on this feedback, we have made changes to some of our proposals.

#### Higher and lower-risk consumer credit activities and limited permission

- 2.5** An important part of our regime is the distinction between higher-risk and lower-risk activities. Firms will be regulated and supervised differently depending on which category they fall into. Table 1 illustrates the differences.

- 2.6** A key difference set is that firms carrying on lower-risk activities only will be able to apply for a limited permission, instead of full authorisation. In addition, these firms will be asked to supply less information to us than firms requiring full authorisation, and will also be subject to reduced approved persons requirements.

- 2.7** Since our last consultation, the Government has made some changes to the list of activities that are treated as lower risk. We set out the changes they have made in Annex 1.

#### The impact of our regime on competition in the market

- 2.8** Some respondents expressed concern that our proposals could affect competition in the consumer credit market, particularly in the debt advice and higher-risk lending sectors. Concerns were raised that the cost benefit analysis (CBA) had failed to take account of these consequences.

- 2.9** As a result of this feedback, in our CBA<sup>3</sup> in this paper, we consider new evidence from our previous consultation and specialist consultants, Europe Economics.<sup>4</sup> Full details can be found in the CBA and associated report by Europe Economics, but the key points are:

- there is a higher estimate of the number of firms that may leave the market
- there are higher estimated compliance costs
- we do not assume that lending by small non-bank lenders through retail intermediaries will be replaced with lending by banks – this means that in the retail intermediary segments, firms leaving the market may lead to a small reduction in available credit for consumers

<sup>2</sup> It is for a firm to show it complies with a corresponding provision. The draft rules include notes which provide some assistance on where rules are based on existing provisions.

<sup>3</sup> Annex 5

<sup>4</sup> Europe Economics (EE) revised its analysis of impacts on consumers in light of new evidence, including feedback to our CP13/7. This increased the scale of predicted firm exit and compliance costs, which resulted in several changes. For example, for debt collection firms the expected level of exit has increased, and is now closer to the levels expected for non-bank lenders and credit brokers.

- firms leaving the market are expected to be primarily those where consumer credit represents a small proportion of their business – as a result, though a significant number of firms are expected to exit, supply of lending and services should not be materially affected
- we expect the number of firms in the most affected segments to remain high, so overall detrimental impacts on competition are not expected to be material
- we expect reduced detriment across consumer credit markets in a range of ways, including from improved compliance (e.g. reducing unaffordable lending, reduced conflicts of interest, better value-for-money)
- in the high-cost short-term credit sector, we expect a more significant market exit and reduction in lending in the short term as a result of our proposals; we expect this reduction to arise predominantly from lenders adjusting their lending to make it affordable and that, overall, it should benefit consumers

### **The new Consumer Credit sourcebook in our Handbook**

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- 2.10** We set out the legal structure of our new regime in our previous consultation and we have now started to make the rules for the new regime.
- 2.11** As part of this, we have created a new sourcebook in our Handbook.<sup>5</sup>
- 2.12** This Consumer Credit sourcebook (CONC) will include both the conduct requirements for consumer credit firms, and the prudential requirements for debt management firms.
- 2.13** As explained in the accompanying policy statement (Part B of this document), our high-level standards (for example, those on status disclosures and systems and controls) will apply to consumer credit firms. We have tailored these where appropriate (for example, depending on the activities of the firm). Firms should be aware that we have changed our proposals on the disclosures they must make, so that they will not be required to disclose that they hold an interim permission in this period. This is a sensible change which reduces the changes firms will need to make to their customer-facing documents.

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<sup>5</sup> [www.fshandbook.info/FS/html/FCA/](http://www.fshandbook.info/FS/html/FCA/)

## Our interim permission regime

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### What is interim permission?

**2.14** Consumer credit licences from the OFT will expire on 31 March 2014. If a firm currently holding a licence wants to continue carrying out consumer credit activities from 1 April 2014, it must have registered for an interim permission from us to do so legally (or, if the firm is already FCA authorised, it should register for an 'interim variation of permission').

**2.15** Firms can register for interim permission now on our website.<sup>6</sup>

### Authorisation after April 2014

**2.16** From 1 April 2014 we will make available the forms firms need to be fully authorised by us. This application will be more detailed and will need to be completed in full. We must determine our decision on the application within six months of receiving a completed application; while all received applications must be determined within twelve months. We will shortly consult on our fees, but the costs of authorisation will be proportionate and based on the type and size of a firm and the level of risk it poses to consumers.

**2.17** Many of our new requirements for the firms under our regime do not apply to a firm until it is authorised. Once a firm is authorised, the following requirements will apply:

- Approved persons requirements
- Prudential standards for debt management firms
- Client assets for debt management firms (including client asset operational oversight function approved person)
- Requirements relating to controllers
- Periodic reporting
- Complaints reporting and publication rules

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<sup>6</sup> [www.fca.org.uk/firms/firm-types/consumer-credit](http://www.fca.org.uk/firms/firm-types/consumer-credit)

### Key points about our interim permission regime for firms

- If you do not register for an interim permission you must stop carrying out regulated consumer credit activities after 31 March 2014. If you do not, you may be committing a criminal offence and you could face enforcement action.
- If you are already authorised by the FCA or PRA you will not automatically be given an interim permission; you still need to register for an interim variation of permission if you wish to continue to carry on regulated consumer credit activities.
- You must pay the required fee when you register, unless you are exempt<sup>7</sup>. We set out the fees in our Policy Statement 13/7.<sup>8</sup>
- Your consumer credit licence must still be valid on 31 March 2014 for you to qualify for an interim permission.
- If you want to carry out additional consumer credit activities during the interim permission period you will need to apply for full authorisation before you start those activities and you will need to apply for all of your activities including those to which the interim permission applies (excluding second-charge lending<sup>9</sup>).
- From 1 April 2014 you will need to make the standard status disclosure on your letters to customer and electronic equivalents required of all FCA firms (see GEN 4 in the Handbook). You need to be fully authorised before you appoint an appointed representative.

### Interim permission for specific sectors

**2.18** Since March the Government has clarified its interim permission proposals for some specific sectors.

- **Peer-to-peer lending platforms**<sup>10</sup> holding licences from the OFT that cover 'debt administration' will be able to obtain an interim permission to carry on the new regulated activity of operating an electronic system in relation to lending and, if applicable, for debt administration.
- **Third party tracing agents**, currently licensed for debt collection but carrying on no other regulated activities, will not need to be authorised from 1 April, so will not need an interim permission. An authorised firm outsourcing tracing to such an agent will be held fully responsible for the carrying on of the activity.

<sup>7</sup> See Chapter 3 to see if you are exempt.

<sup>8</sup> [www.fca.org.uk/static/documents/policy-statements/ps13-07.pdf](http://www.fca.org.uk/static/documents/policy-statements/ps13-07.pdf)

<sup>9</sup> See Chapter 10 on second charge lending

<sup>10</sup> Persons who merely trace borrowers who owe debts under consumer credit agreements or consumer hire agreements, and take no other steps to procure payment.

- **Not-for-profit debt** advice bodies that hold individual consumer credit licences will have to register for an interim permission, but will not have to pay a fee. Not-for-profit bodies providing debt advice that are covered by a group consumer credit licence will go directly into the limited permission regime so they will not need to register for an interim permission (details on the process for these firms will be provided by the group licence holders) and they will not have to pay a fee.
- A **professional** firm holding an individual consumer credit licence may want to consider whether it can qualify as an Exempt Professional Firm (EPF) (see Chapter 3 for information on EPFs), as an alternative to authorisation, before it registers for an interim permission (see Chapter 10 for more details). A professional firm that cannot qualify as an EPF, and operates only under a group consumer credit licence, will need to have an individual consumer credit licence from the OFT before being able to register for an interim permission.<sup>11</sup>
- **Insolvency practitioners** that currently hold credit licences should consider the new exemption under FSMA.<sup>12</sup> Insolvency practitioners, official receivers and judicial factors would not need permission to carry on debt adjusting, debt counselling, debt administration or debt collecting when acting in that capacity. In addition, a person acting in reasonable anticipation of being appointed as an insolvency practitioner is exempt in relation to debt adjusting, debt counselling and providing credit information services. The exemption does not include the lending activity (article 60B of the Regulated Activities Order) nor the hiring activity (article 60N). These persons will only need an interim permission if they want to carry on the regulated activities not included within the exemption under the new regime.

**2.19** Firms should also check the details of their OFT licence, and if necessary contact the OFT to seek to have the licence amended, before they register for an interim permission. For example, firms that hold credit licences that include ‘non-commercial debt counselling’ may not automatically meet our definition of a ‘not-for-profit debt advice body’<sup>13</sup> (in which case they will not be able to take advantage of the different regime for these bodies, as set out above).

<sup>11</sup> [www.offt.gov.uk/OFTwork/credit-licensing](http://www.offt.gov.uk/OFTwork/credit-licensing)

<sup>12</sup> See article 52 of the Financial Services and Markets Acts 2000 (Exemption) Order 2001 - [www.legislation.gov.uk/ukSI/2001/1201/contents/made](http://www.legislation.gov.uk/ukSI/2001/1201/contents/made)

<sup>13</sup> A body which by virtue of its constitution or any enactment: 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 is prohibited from directly or indirectly distributing among its members any part of its assets (otherwise than for charitable or public purposes).

**Table 2.1: 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 not under hire purchase or conditional sale agreements). 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.

**Credit broking**

Broking where their 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. This does not include where broking is carried on in the consumer's home on more than an occasional basis. Following feedback, we have also added green deal broking and the broking of vehicle lease contracts to the lower-risk regime.

**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 organisation.

**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 organisation.

**Table 2.2: Higher-risk regime****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 brokerage**

Including introducing consumers to lenders. But excluding brokerage by sellers of goods and non-financial services as a secondary activity (unless the brokerage 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 not-for-profit debt counselling.

**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.

**Peer-to-peer lending**

The new regulated activity proposed by the Government

Table 2.3: Features of the higher- and lower-risk regimes

		Differentiated features					
		Authorisation process	Appointed reps	Pre-approval of individuals (approved persons)	Supervision	Reporting	Capital requirements
Higher-risk	Full authorisation process	Most lenders and all credit reference agencies may not become appointed representatives	Pre-approval of individuals with governance functions (and other significant influence functions for certain firms)	Targeted, proactive supervision, according to risk profile of firm	Limited to key information	Capital requirements for all commercial debt management firms and large not-for-profit debt advice bodies	
Lower-risk	Limited permission process	May become an appointed representative	Pre-approval generally limited to apportionment & oversight function No approved person requirements for most not-for-profit providers of debt advice	Limited reactive response to problems that have already materialised. Possible limited thematic work.	Limited to basic information	Not applicable	
		Common features of both regimes					
Rule-making powers		High-level and conduct rules, complaints recording and publication	Wide enforcement powers	Powers over individuals	Client money regime applicable to all firms, though with slightly fewer requirements for smaller firms		

## 3.

# Authorisation and the potential alternatives

When deciding whether to grant a firm authorisation, we assess whether it complies with our 'threshold conditions'.<sup>1</sup> These are the standards we require firms to meet, which differ according to the type, size and potential risk a firm poses to consumers.

If an individual wants to carry out certain activities (that we call 'controlled functions') for a firm, they also need to apply to become an 'approved person'.<sup>2</sup>

In March we proposed to apply our threshold conditions and our requirements for approved persons to consumer credit firms. This chapter sets out our proposals including where we are proposing to make changes. We also set out alternatives to becoming authorised and updated proposals for these options.

Implementing our approach to applying approved persons requirements to consumer credit firms may be subject to some change as our thinking develops on the recommendation by the Parliamentary Commission on Banking Standards that a new 'Senior Persons Regime' and licensing regime should replace the approved persons regime for deposit-taking institutions (banks, building societies and credit unions).

### Applying for authorisation

- 3.1** Firms and individuals carrying on regulated financial services activities in the UK must be authorised by us, unless they are exempt. To become authorised, firms apply to us using forms that we make available online. You can find more details on our authorisation process, as well as help and guidance on what it means for firms, on our website.<sup>3</sup>
- 3.2** Consumer credit firms can apply to be fully authorised by us from 1 April 2014. We will provide more information about our fees before April, but the costs of authorisation will be proportionate and based on the type and size of a firm and the level of risk it poses to consumers.

<sup>1</sup> See table 3.1 for details

<sup>2</sup> See table 3.2 for details

<sup>3</sup> <http://www.fca.org.uk/firms/about-authorisation>

### Do overseas firms need to be authorised?

Overseas firms will not need to be authorised if they:

- provide their services entirely at a distance by electronic means from an EEA Member State under the E-Commerce Directive
- are EEA firms passporting under certain financial services single market directives and meeting certain conditions
- meet the conditions under Schedule 4 to FSMA

Other overseas firms will need to be authorised.

### Threshold conditions for consumer credit firms

- 3.3** Threshold conditions are the standards that we require firms to meet threshold conditions to qualify for FCA authorisation.
- 3.4** We will be applying our threshold conditions to consumer credit firms in line with the position set out in our March consultation paper. These firms will need to prove that they meet our threshold conditions when they apply for authorisation from 1 April 2014.
- 3.5** We will have a risk-based approach depending on whether a firm is carrying on higher-risk or lower-risk activities.
- 3.6** We will implement the proposals set out in Table 3.1 at the end of this chapter, and we are updating the rules in our Handbook to reflect this (see Appendix 2 for more details).<sup>4</sup>

**Q1: Do you have any comments on the way our threshold conditions are being applied to consumer credit firms and/or the updates to our Handbook rules?**

### Approved persons in consumer credit firms

- 3.7** If an individual wants to carry out a particular activity in a firm that we define as a 'controlled function', they must apply to become an 'approved person'. We set out what these functions are and how we propose to apply the relevant requirements for approved persons to credit firms in Table 3.2 at the end of this chapter.

<sup>4</sup> The COND sourcebook in our Handbook sets out our minimum standards for becoming and remaining authorised.

### Our proposals in March

**3.8** In March we set out our key proposals for approved persons in consumer credit firms, which were:

- We would generally apply governing functions<sup>5</sup> to those directing a firm's affairs.
- Firms that have a limited permission authorisation in respect of their credit activities would be required to have a single person authorised for the apportionment and oversight function in respect of those activities and would not be required to have anyone approved for the governing functions in respect of those activities. This does not apply to not-for-profit debt advice bodies who are not required to have anyone approved for either the governing functions or the apportionment and oversight function.
- No customer function would apply to credit activities.
- The compliance oversight function would apply to authorised debt management and credit repair firms.
- The 'money laundering reporting officer' function would apply to authorised firms covered by the Money Laundering Regulations (except for 'limited permission' lenders).
- Responsibility for the 'client asset oversight' function would fall on one person in each profit-seeking debt management firm approved for another controlled function.
- No controlled functions would be applied to not-for-profit bodies providing debt advice.
- To apply them in a proportionate way, so we can limit the cost and burden on firms to only what is necessary to protect consumers.

### Our proposed changes

**3.9** We are proposing the following changes to the way we apply approved persons requirements to consumer credit firms:

- Not-for-profit providers of debt advice that hold £1 million or more of client money will need to have a director or senior manager approved to carry out the 'client asset operational oversight' function.
- Profit-seeking debt management firms will only need to have a director or senior manager approved to carry out 'client asset operational oversight' if the firm holds £1 million or more of client money.
- Smaller profit-seeking debt management firms and not-for-profit providers of debt advice (holding less than £1 million of client money) will need a director or senior manager to be responsible for overseeing the firm's holding of client assets. In the case of profit-seeking debt management firms, this person must be someone who has been approved for a 'significant influence function' - most likely a governing function (see Table 3.2 for a description of these functions).

<sup>5</sup> See table 3.2

- Authorised firms whose main activity is not a regulated credit activity – apart from firms with limited permissions and some authorised professional firms for non-mainstream regulated credit activity<sup>6</sup> – will need to have approved persons to carry out ‘significant influence functions’ including the ‘governing’ functions’.
- We have limited (and clarified) our application of approved persons requirements to sole traders (see below).<sup>7</sup>

### Some key proposals we are clarifying in relation to sole traders

- The ‘money laundering reporting officer’ function and the compliance oversight function would not apply to sole traders **if they have no employees** (involved in the carrying on of the regulated business activity).
- The apportionment and oversight function would only apply to sole traders **if they employ people who have to be approved persons**.
- The systems and controls functions and the significant management functions are unlikely to apply to sole traders – but may do in limited circumstances in which they have a substantial number of employees involved in the carrying on of regulated business activities. Even under such circumstances, responsibility for these functions would apply to an employee of the sole trader rather than the sole trader itself.<sup>8</sup>
- Where an authorised professional firm has approved persons to perform the governing functions for its mainstream activities, with equivalent responsibilities for its non-mainstream (incidental) regulated credit activities, it would not need to have an approved person for the ‘apportionment and oversight’ function.
- Where a firm is an appointed representative for its non-investment insurance mediation activity and for a credit activity (e.g. credit brokerage), and its main purpose is to carry on activities other than regulated activities (e.g. a motor dealer), it would need one approved person for the ‘governing’ function for each activity (this can be the same person).
- Where a firm is an appointed representative for its non-investment insurance mediation activity and has limited permission for a credit activity, it would need an approved person for the ‘governing’ function for the insurance mediation activity and an approved person for the ‘apportionment and oversight’ function for its limited permission credit activity (e.g. secondary credit brokerage).
- We are minded not to apply a customer function<sup>9</sup> to any consumer credit activity at this time.

<sup>6</sup> See SUP 10A.1.17R <http://fshandbook.info/FS/html/handbook/SUP/10A/1>

<sup>7</sup> An individual who is a firm

<sup>8</sup> Either the sole trader itself or the FCA could take a view as to whether or not the significant management functions or systems and controls functions should apply to a particular sole trader

<sup>9</sup> 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.

The way we apply approved persons requirements to banks could change or be delayed as we further consider recommendations by the Parliamentary Commission on Banking Standards (PCBS). This means we may need to consult again on revised proposals.

The PCBS recently published its final report, *Changing banking for good*. One of its recommendations was that we should replace our approved persons regime, as applied to deposit-taking institutions, with a 'Senior Persons Regime' (SPR) to ensure that the most important responsibilities in deposit-taking institutions are assigned to specific, senior individuals so they can be held fully accountable for their decisions and the standards of their deposit-taking institution in these areas, and a licensing regime covering a wider population of individuals whose actions or behaviour could harm a firm, its reputation or its customers.

However, we are continuing at this time to consult on our proposals to apply approved persons requirements to all consumer credit firms.

No matter what happens, we expect all consumer credit firms to have the right people responsible for important functions to ensure that consumers are protected.

**Q2: Do you agree with the updates to our draft Handbook rules for approved persons for consumer credit firms?**

**Alternatives to authorisation**

**3.10** There are alternatives to becoming authorised which allow for some unauthorised firms and individuals to legally carry on regulated activities. These include:

- being an 'appointed representative' of an authorised firm
- being a 'self-employed agent'
- being an 'exempt professional firm'

**Being an appointed representative**

**3.11** An appointed representative 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 FCA.

**3.12** In March, the Government proposed that most consumer credit firms should be able to be an appointed representative, apart from lenders and credit reference agencies. We proposed that consumer credit firms that are acting as appointed representatives should be able to enter into multi-principal arrangements – unless they are debt collectors.

- 3.13** The Government has decided that becoming an appointed representative should be an option for most consumer credit firms, including lenders if they are providing interest-free credit without any other charges. However, credit reference agencies will not have this option. The Government has also not, at this time, extended the option to be an appointed representative to peer-to-peer lending platforms carrying on the new regulated activity of ‘operating an electronic system in relation to lending’.
- 3.14** We are now minded to allow multi-principal arrangements to be an option for appointed representative debt collectors. We are persuaded that not to allow appointed representatives carrying on debt collection to enter into multi-principal arrangements could potentially have an adverse impact on the operation of the sector in a way that could harm the interests of those being pursued for multiple debts in particular<sup>10</sup>.

**Q3: Do you have any comments on the updates to our draft rules regarding appointed representatives of consumer credit firms?**

**Being an exempt professional firm**

- 3.15** A professional firm that is a member of a Designated Professional Body (DPB) can carry on certain regulated activities under the regulation and supervision of its DPB rather than the FCA if it fulfils certain criteria set out in FSMA. These firms are known as exempt professional firms (EPFs).
- 3.16** The Government has decided that EPFs should be able to carry on certain consumer credit activities if their DPB puts appropriate rules and supervisory arrangements in place.
- 3.17** DPBs will have the option to apply an equivalent transitional arrangement to the one that we propose to apply to authorised firms from 1 April 2014. This means that if an EPF can demonstrate that it has acted in accordance with equivalent CCA requirements and OFT guidance, that were applicable immediately prior to 1 April 2014, the DPB will not take action against it in relation to corresponding new DPB rules that are substantially the same.
- 3.18** If professional firms do not fulfil the criteria to be an EPF, they will need to consider whether they need to be authorised by us in order to be able to carry on their consumer credit activities, or whether they are otherwise exempt (see reference to insolvency practitioners below) or their credit activities are excluded<sup>11</sup> from regulation. These firms can register with the FCA for interim permission (see Chapter 2) if they have an individual OFT licence. If they currently operate under a group licence, they will need to obtain an individual licence from the OFT before they can register for interim permission with the FCA. Firms with interim permissions will subsequently be considered (between 1 April 2014 and 1 April 2016) for full authorisation by the FCA.

**Insolvency practitioners**

- 3.19** Some DPBs have insolvency practitioners (IPs) as members. IPs whose activities are limited solely to certain specified matters<sup>12</sup> will, in any case, be exempt. The scope of exemption has been extended beyond the position on which the Government consulted in March to additionally include an IP carrying on debt adjusting, debt counselling, debt collection, debt administration or credit information services in reasonable contemplation of appointment as an IP.

<sup>10</sup> See our response to question 8 of CP 13/7 in Annex 1.

<sup>11</sup> Solicitors are excluded from certain regulated credit activities if they are acting in the course of ‘contentious business’ – this is business done in or for the purposes of proceedings begun before a court or before an arbitrator. This exclusion applies to (amongst other matters) debt collection (see Article 39K of the RAO).

<sup>12</sup> See Article 52 of the Financial Services and Markets Act 2000 (Exemption) Order 2001 as amended.

**Being a self-employed agent**

**3.20** In March we said that we thought that self-employed agents in the home-collected credit sector that fulfil certain criteria should be considered as carrying on the business of the firm they are representing. So they would not need to be authorised or to become appointed representatives.

**3.21** The Government also proposed to allow self-employed agents of mail order firms to continue to be exempt from the requirements of carrying on 'credit broking' and certain other ancillary credit activities in specific circumstances. The Government has amended this exemption so that the financing of the credit agreement can be done by a firm in the same corporate group as the mail order firm, and so that visits to customers and potential customers by the agents of mail order firms can be pre-arranged ('solicited').

**3.22** We are now consulting on guidance on the factors that are relevant in deciding whether a person is to be treated as carrying on his own business (in which case he may require authorisation unless an exemption or exclusion is available) or whether he is carrying on his principal's business (in which case he will not require authorisation). This includes guidance that meeting the following criteria is likely to mean that a person is an agent of a principal's business and does not require authorisation on the grounds that he is carrying on the business of the principal (in the case of home-collected credit, the credit provider) and not his own:

- the principal appoints the self-employed agent as an agent
- the agent only works for one principal
- the principal has FCA permission for every activity the agent is carrying on for which the principal would need permission if it was carrying on the activity itself
- there is a contract in place setting out effective measures for the principal to control the agent
- (in the case of collecting debts) repayment received by the agent is treated as being received by the principal, so the customer is not harmed if the agent becomes insolvent before the money is passed to the principal
- the principal accepts full responsibility for the conduct of its agent when it is acting on its behalf in the course of its business
- the agent makes it clear to customers that it is representing a principal and the name of that principal

**Q4: Do you have any comments on the criteria that we are proposing a person would have to fulfil to be a self-employed agent of a principal firm (as set out in Appendix 2)?**

**Table 3.1 – Threshold conditions**

<b>Threshold Condition</b>	<b>Explanation</b>	<b>Proposed approach for higher-risk firms</b>	<b>Proposed approach for lower-risk firms applying for a limited permission</b>
<b>Legal status</b> (Does not apply to FCA only regulated firms i.e. those that are not also regulated by the PRA)	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.
<b>Location of offices</b>	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.
<b>Effective supervision</b>	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. Complete automated checks on key controllers. Only complex ownership structures to be investigated.
<b>Appropriate resources</b>	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.

<b>Threshold Condition</b>	<b>Explanation</b>	<b>Proposed approach for higher-risk firms</b>	<b>Proposed approach for lower-risk firms applying for a limited permission</b>
<b>Suitability</b>	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.
<b>Business model</b>	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

**Table 3.2 – Approved persons proposals**

<b>Significant influence functions</b>	<b>Responsibilities</b>	<b>Our proposals</b>
<b>Governing functions</b>	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"> <li>• firms with limited permissions</li> <li>• some authorised professional firms in respect of their non-mainstream regulated credit activity (this may include, for example, law firms that on an incidental basis recover consumer credit related debts on behalf of their clients)</li> <li>• sole traders</li> </ul> <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 principal 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 for that activity.</p>

<b>Significant influence functions</b>	<b>Responsibilities</b>	<b>Our proposals</b>
<b>Apportionment and oversight function</b>	Ensure that the significant business responsibilities are clearly and appropriately divided among the directors and senior managers of the firm and that they oversee the implementation and maintenance of appropriate systems and controls.	Apply to individuals performing this function in the following firms: <ul style="list-style-type: none"> <li>• firm's with limited permissions (except for not-for-profit debt advice bodies)</li> <li>• some authorised professional firms in respect of their non-mainstream regulated credit activity.<sup>12</sup></li> </ul> It would not apply to sole traders unless they employ people who have to be approved persons. Most limited permission firms 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 in respect of their credit-related activities.
<b>Compliance oversight function</b>	Oversight of the firm's regulatory compliance and reporting to the governing body about that.	Apply to individuals performing this function in the following authorised firms (including sole traders that employ staff involved in the carrying on of the regulated business activities): <ul style="list-style-type: none"> <li>• debt management businesses</li> <li>• credit repair businesses</li> </ul>
<b>Money laundering reporting officer function</b>	The firm's money laundering reporting.	Apply to individuals performing this function in authorised firms (including sole traders that employ staff involved in the carrying on of the regulated business activities) that are covered by the Money Laundering Regulations. It does not apply to 'limited permission lenders'.
<b>Systems and controls functions</b>	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.	Apply to individuals performing these functions in all authorised firms except: <ul style="list-style-type: none"> <li>• firms with limited permissions</li> <li>• some authorised professional firms in respect of their non-mainstream regulated credit activity</li> </ul> Although this function may apply to sole traders, it is unlikely to do so other than in circumstances in which the sole trader has a substantial number of employees involved in the carrying on of regulated business activities. Responsibility for this function can be assumed by a person already approved to undertake a governing function other than the non-executives. 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.

Significant influence functions	Responsibilities	Our proposals
<b>Significant management functions</b>	Only applies to firms where significant responsibility is given to a senior manager of a relatively substantial business.	<p>Apply to individuals performing these functions in all authorised firms except:</p> <ul style="list-style-type: none"> <li>• firms with limited permissions</li> <li>• some authorised professional firms in respect of their non-mainstream regulated credit activity</li> </ul> <p>Although this function may apply to sole traders, it is unlikely to do so other than in circumstances in which the sole trader has a substantial number of employees involved in the carrying on of regulated business activities.</p> <p>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 significant influence over the firms' business.</p>
<b>Protecting clients' money and assets</b>	Person responsible for the firms' client asset oversight.	<p>Apply to a director or senior manager in a large debt management firm (including a sole trader) and a large not-for-profit provider of debt advice (in each case 'large' means holds a minimum of £1m of client money at some point during the calendar year).</p> <p>Smaller profit-seeking debt management firms and not-for-profit providers of debt advice (holding less than £1 million) will need a director or senior manager to be responsible for overseeing the firm's client assets. In the case of profit-seeking debt management firms, this person must be someone who has been approved for a 'significant influence function' (most likely a governing function).</p>

13 (doesn't apply where the firm has a person approved for a governing function in respect of its mainstream activity who has equivalent responsibility for its non-mainstream regulated credit activity)

## 4.

# How we will supervise firms and collect data

Our reporting requirements set out the information that firms need to provide us, how it should be provided and how often. We then use this information to support the activities we undertake to achieve our objectives.

In this chapter we set out our detailed proposals for the data that we will collect through regulatory reporting and also provide more detail on our overall supervisory approach. We also clarify some aspects of our approach to supervision, including how we categorise and oversee different firms to ensure that consumers are protected. For more details on the way we supervise firms, see the [Journey to the FCA](#), and [FSA CP 13/7](#).

### Why do we have reporting requirements?

- 4.1** We ask our regulated firms to report a wide range of data, which we rely on to fulfil our objectives as an organisation. We examine the data to answer a wide range of questions, from the number and type of firms operating in a particular market, to the more complex issues of whether a market is functioning well.
- 4.2** We want to collect data that will help us to deal with the risks to customers posed by consumer credit firms. From this we will gather and maintain a good picture of the overall size and breakdown of the consumer credit market, firms, consumers and products, which will help us to focus our resources on the sectors, issues and risks that are of greatest significance.

### Our proposals for consumer credit firms<sup>1</sup>

- 4.3** We believe that our proposed reporting requirements<sup>2</sup> for consumer credit firms are proportionate to the risk they pose to consumers and the size of their business. So they should not cause undue burden or disruption to the industry.

<sup>1</sup> We are not proposing any periodic reporting requirements for credit reference agencies or not-for-profit bodies (except not-for-profit debt advice bodies).

<sup>2</sup> The regulatory reporting requirements will be set out in SUP 16.12 as part of the Handbook rules for credit, under a new Regulated Activity Group (RAG) 12. Product sales data requirements will be set out in SUP 16.11.

**4.4** We are aware that many consumer credit firms are small businesses that are new to being regulated by us, but we believe that the data we will ask for should already be available to most firms.

**When will our reporting requirements come into effect?**

**4.5** We intend our reporting requirements to come into effect on 1 October 2014 and that they will only apply to firms that are fully authorised.<sup>3</sup>

**4.6** We will not regularly collect data from firms with interim permission (see Chapter 2), but we will reserve the right to ask for information from individual firms when we need it to help us supervise them.

**How often and when will firms need to report their data?**

**4.7** How often we will ask for data will depend on the size of the firm – although we propose that the frequency of reporting will be either annual or six-monthly and aligned to a firm's financial year end.

**4.8** For example, we propose that firms generating revenue of more than £5m per year from consumer credit business should report their data to us every six months. This reflects the greater risk that larger firms pose to consumers, as they have a bigger impact on the sector as a whole.

**4.9** The reporting regime consists of two components – regulatory reporting and product sales data reporting (PSD).

**4.10** Firms that are already regulated by us will not need to resend data that they already submit (for example, financial information).

**How will firms submit their data?**

**4.11** Firms will submit their data using our 'GABRIEL' electronic reporting system - we will provide guidance to firms that are unfamiliar with our systems.

**4.12** Firms will have 30 business days to submit their data. We set out in Table 4.1 how the proposed reporting forms will apply. Full details of our proposals are set out in Appendix 2.

**Collecting product sales data (PSD)**

**4.13** Product sales data relates to specific details about each individual sale of a particular type of product. We already collect PSD on mortgages, investment and insurance products, and we propose to also do so for certain consumer credit products.

**4.14** We intend our PSD requirements to come into effect on 1 October 2014 and for them to apply to firms that are fully authorised to 'enter into a regulated credit agreement as a lender' of high-cost short-term credit and home collected credit.<sup>4</sup> We want to apply our PSD requirements to these particular firms because we know that consumers are suffering harm in these sectors, and we want to address this.

<sup>3</sup> Once authorised, the firm will receive information explaining how and what to report and the frequency of reporting.

<sup>4</sup> The requirement to submit product sales data, will be added to the existing PSD rules that are set out in our Handbook. Firms will be required to submit the data on a calendar quarters basis. All sales made within a quarter must be reported on our GABRIEL system within 20 business days of the end of each quarter.

- 4.15** We may expand the scope of our PSD requirements as our understanding of the market develops.

#### **Collecting close links and controllers annual reports**

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- 4.16** Close links and controllers data provide us with the information we need about who owns and directly or indirectly controls firms. We currently require firms undertaking certain activities to send either monthly, annual or event-driven reports.
- 4.17** We propose that firms carrying out consumer credit activities will not be required to submit close links or controllers reports in accordance with Sup 16.4 and SUP 16.5 unless they are already required to do so. This is because we do not believe it is really necessary and we are trying to minimise the burden on firms.
- 4.18** The requirements on firms to notify the FCA of changes to their close links or controllers set out in SUP 11 will apply to credit firms.

#### **Reporting requirements for authorised professional firms (APFs)**

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- 4.19** We propose the following requirements for APFs who undertake credit-related activities:
- If they carry out consumer credit activities as a mainstream activity and are subject to the financial requirements for a debt management firm they will be subject to the full reporting requirements. This is because we believe they should report financial, capital, CASS and other data in the same way as other firms carrying out this type of business.
  - If they carry out consumer credit activities as a mainstream activity but they are not subject to the financial requirements for a debt management firm they will have to fill out a questionnaire. We will add a question to the existing APF questionnaire that will capture how much of their income is generated by consumer credit activities.
  - If they carry out consumer credit activities as a non-mainstream activity they will not have any reporting requirements.
- Q5: Do you have any comments on our proposed regulatory reporting regime?**
- Q6: Do you agree with our proposals to collect product sales data on high-cost short-term lending and home collected credit?**

**Table 4.1 – How the proposed reporting forms will apply**

<b>Form</b>	<b>Application</b>	<b>Content overview</b>
<b>CCR001: Financial data</b>	All firms that are not already submitting financial data and do not have <i>limited permission</i> or permission only to carry on P2P lending platform activity (but applies to a large not-for-profit debt advice body subject to the prudential requirements that apply to debt management firms).	Key financial figures including capital, assets, liabilities, exposures, income and profit.
<b>CCR002: Volumes</b>	All firms that do not have <i>limited permission</i> (but applies to a large not-for-profit debt advice body subject to the prudential requirements that apply to debt management firms).	For each activity a firm undertakes, revenue, customer and transaction volume, and an indication of the main method used to generate income.
<b>CCR003: Lenders</b>	All firms with permission to enter into a regulated credit agreement as a lender or to exercise the lender's rights and duties under a regulated credit agreement.	Breakdown of value and amount of loans, arrears and interest rates.
<b>CCR004: Debt management</b>	Debt management firms and <i>large not-for-profit debt advice bodies</i> subject to the prudential requirements that apply to debt management companies .	Capital requirement and capital resources. Number of debt management plans ending early.
<b>CCR005: Client money and assets</b>	Debt management firms and not-for-profit debt advice bodies.	Highest balance and number of clients. Amount of client money held for longer than 5 days.
<b>CCR006: Debt collection</b>	Firms undertaking debt collecting including P2P lending platforms that collect debts due under loans they facilitate.	Breakdown of number and value of debts by stage of placement.
<b>CCR007: Key data<sup>5</sup></b>	Firms with limited permission, other than an APF, or a not-for-profit debt advice body, that is subject to full reporting requirements).	Credit related income, total revenue, number of transactions and complaints, main credit-related activity.

**4.20** Table 4.2 summarises the information that we propose to collect through PSD reporting, and the reasons for collecting it.

**4.21** The proposed data is similar to mortgage PSD – i.e. it is concerned with customer and loan information, although is less extensive, and will be submitted using the same method (via the GABRIEL system).

<sup>5</sup> Firms with limited permission, other than not-for-profit debt advice bodies described above, will only have to submit CCR007

The main difference, however, is that while mortgage PSD will require firms to update loan details throughout the term of the loan, we are currently proposing that consumer credit will only be concerned with the original sale of the loan.

**Table 4.2 – Product Sales Data**

<b>Information to be reported</b>	<b>Rationale for collection</b>
The FCA reference number of the lender and broker (if different)	We will use PSD data for many different purposes, which include: <ul style="list-style-type: none"> <li>• Assessing firms' customer profiles and identifying vulnerable consumer groups.</li> <li>• Assessing trends in products, customer types and locations to identify emerging risks</li> <li>• Supporting early assessment of the scale of emerging risks</li> <li>• Developing firm risk profiles</li> <li>• Understanding consumer and firm behaviour</li> <li>• Informing consumer segmentation modelling</li> <li>• Identifying potential competition issues</li> <li>• Identifying changes in a firm's product or customer focus</li> <li>• Analysis of basic conduct considerations, such as affordability or treating customers fairly.</li> </ul>
The type of loan: high-cost short-term or home collected credit	
Loan details: amount, term, interest rate, fee	
Rollover information	
The reason the loan was taken (if known)	
Date of birth and postcode of the borrower	
Borrower and household income	
Borrower statuses: marital, residential, employment, car ownership	

### More detail about the proposed supervisory regime

**4.22** Once consumer credit firms have come into the new regime, elements of our supervisory approach will be phased in. We do not propose that all the elements of supervision referred to here and in our previous consultation will operate immediately for all firms, although ultimately the roll out of supervision will be aligned with the FCA supervision model, which applies to all regulated firms.<sup>6</sup>

#### Firm classification

**4.23** A key driver to determining the intensity of our supervisory activity will be classifying firms by applying a firm categorisation. Firm categories are determined according to how much risk they pose to our objectives. The proposed key drivers for this will be firm size and the number of retail customers. However, we are not proposing that individual firm categories are determined solely by the particular sector of the credit market a firm participates in.

**4.24** Consumer credit will follow the same FCA firm classification model that is applied to all firms. Firms will fall into one of four conduct categories: C1, C2, C3 or C4. We will provide more information about firm categorisation and how this will be applied as our understanding of the credit market and individual firms' business models develops. We will update our stakeholders as our work progresses in this area. Firms will be categorised once they have become fully authorised.

<sup>6</sup> See our *Journey to the FCA*

**C1 and C2 firms** - will be classed as *'fixed portfolio'*, which means they will have a dedicated supervisor.

**C3 and C4 firms** - will be classed as *'flexible portfolio'*, which means they will be supervised by a team of sector specialists and not have a dedicated supervisor.

### Smaller firms

- 4.25** As we have set out above, a firm's size will be reflected in its categorisation. The largest firms will be in the C1 category and the smallest in the C4 category. We expect that the vast majority of firms will be classified as C4, although it is likely that this population of firms in itself will be quite varied in terms of size, ranging from sole traders to firms with a significant number of customers and staff.

### Firm Systematic Framework (FSF)

- 4.26** It is proposed that the FSF will allow us to assess firms' conduct risks and aims to answer the following question:

*Are the interests of customers and market integrity at the heart of how the firm is run?*

- 4.27** The FSF assessment process will help us come to a view about the extent to which a firm embeds fair treatment of customers and market integrity in the way it is run. This, at the most intensive end of assessment, covers the product/service lifespan from design through to sales/service delivery and after sales/service handling. The assessment of governance and culture will be crucial, as these are key factors that drive whether a firm treats its customers fairly.
- 4.28** For C1 firms, we will carry out firm-by-firm business model and strategy analysis in the context of the market they operate in. For C2 firms we will take a group of similar firms in the same sector to identify common risks, and for C3 firms we will look at a sample of firms' business models across a sector. The outputs from this analysis will inform the firm specific work undertaken in line with where we see the potential for conduct risks to emerge. A less intensive assessment will be applied to C4 firms. This was set out in paragraph 9.13 of FSA CP13/7 under the heading 'The FSF for smaller firms'.

### Prioritising issues and products supervision

- 4.29** This is an area we are currently considering by carrying out detailed analysis of the risks in individual credit activities using existing market intelligence, reviewing the market data available and early engagement with key stakeholders including trade associations.
- 4.30** It is likely that key drivers to determining sector risk priorities will be the amount of potential harm to consumers in a particular activity, the number of consumers affected and their perceived level of vulnerability. We will keep stakeholders updated as our work progresses in this area and will set out our thematic priorities around the time of the transfer.

### Supervisor relationships with existing FCA firms

- 4.31** We will have sector specialists leading on consumer credit supervision for firms that are part of an existing FCA group or an existing FCA firm where credit is not its main activity. However, we propose that the supervisory relationship and main point of contact with the FCA will be through existing FCA supervisory teams and will remain unchanged.

**Supervision in the interim permission regime**

- 4.32** We are proposing an event-driven approach to supervision of firms with interim permission. Where we receive information indicating consumer harm, we will act on it, reacting quickly and engaging with firms at an early stage to address the problem. We will supplement this with thematic supervision of specific issues.
- 4.33** We will have dedicated event supervision to assess, prioritise and mitigate risks identified through the various sources of information coming into the FCA about consumer credit firms. While we do not propose that firms will provide regulatory information as part of a reporting regime in the interim, we will be actively monitoring external market intelligence and information we will receive about individual firms from various stakeholders and consumer groups. We will have powers to make ad-hoc requests to individual firms for information if we believe this is necessary to make our supervisory judgements.
- 4.34** Alongside reactive work, we will undertake thematic projects as part of our issues-based work in the interim. Work of this nature would focus on sector-wide issues or a particular credit activity. This work will contribute to the development of our full supervisory regime, although where we identify harm to consumers through issues-based work in the interim, we will deal with this by engaging directly with individual firms and/or communicating with the industry more widely.

**Financial promotions**

- 4.35** If we consider that a promotion for consumer credit does not meet our requirements, we will have available all the disciplinary tools that we have for firms who currently breach our financial promotions rules.
- 4.36** Therefore, where we see a non-compliant promotion, we will contact the firm, asking them to amend or withdraw it. For repeat breaches, we may also ask them to provide us with a formal attestation (a signed statement) that they have effective governance in place for the approval of compliant financial promotions. In addition, in cases where the firm does not co-operate, we can issue a supervisory notice banning the promotion. In the worst cases, enforcement action may also be appropriate.
- 4.37** When deciding whether to take action, we will apply our current approach of proceeding with cases that pose the greatest risk to consumers and our objectives. This should ensure that we are taking the right cases forward and that we are acting in a proportionate manner.

**Unfair terms in consumer contracts**

- 4.38** If we decide to take action in relation to the fairness of terms in standard consumer contracts, we can apply for an injunction to prevent a firm relying on unfair terms under the Unfair Terms in Consumer Contracts Regulations 1999 ('the Regulations'). The Regulations also provide that, as an alternative to an injunction, we have the power to accept an undertaking from a firm that it will no longer use terms that we consider as likely to be unfair. We publish undertakings from firms on our website.
- 4.39** We may also consider carrying out thematic work, looking at unfair contract terms. An example of such work would include a review of a range of firms' contracts for a particular product. Our thematic work would consider the fairness and clarity of firms' contract terms under the Regulations, alongside firms' practices under our wider regulatory requirements.
- 4.40** Our approach to the assessment of terms under the Regulations is set out in our Handbook in the Unfair Contract Terms Regulatory Guide (UNFCOG).

- 4.41** When it is created (expected in April 2014) the Competition and Markets Authority (CMA) will become the lead enforcer of the Regulations. UNFCOG makes a number of references to the Office of Fair Trading (OFT), as the lead enforcer of the Regulations.
- 4.42** To reflect our role as regulator of consumer credit, we propose two changes to UNFCOG:
- 1.** Replacing references to the OFT with references to the CMA.
  - 2.** Deleting references to the OFT's responsibility for enforcing the Regulations in relation to consumer credit. We will take over responsibility for this in April 2014.
- 4.43** We have discussed the proposed changes to UNFCOG with the OFT and it is in agreement with the revisions to the Handbook text we have suggested.
- 4.44** The section of the Handbook setting out the proposed changes can be found at Appendix 2 at the end of this consultation paper.

## 5. Our rules on conduct standards for all consumer credit firms

In this chapter we consult on our proposed conduct of business standards. These will be located in a new consumer credit sourcebook, which is known as CONC, in our Handbook. This will include:

- rules and guidance which reflect provisions of the CCA and its secondary legislation that are being repealed<sup>1</sup>
- OFT guidance, that we will carry across as either rules or guidance
- new rules described in other chapters applying to peer-to-peer lending and high-cost short-term credit
- some material from existing industry codes

### Our new consumer credit section in our Handbook

- 5.1** Table 5.1 sets out the proposed structure of CONC.
- 5.2** For the conduct of business sections of CONC, we have followed broadly the same structure as other conduct of business sourcebooks. The material derived from OFT guidance and industry codes will be divided up among the sections of CONC, depending on the subject matter.

**Table 5.1 – proposed structure of the conduct of business sections of CONC**

Chapter	Title
CONC 1	Application and purpose
CONC 2	Conduct of business standards: general
CONC 3	Financial promotions
CONC 4	Pre-contractual disclosure
CONC 5	Responsible lending
CONC 6	Post-contractual requirements

<sup>1</sup> Cancelled and replaced with FCA rules and guidance.

<b>Chapter</b>	<b>Title</b>
CONC 7	Arrears, default and recovery (including repossessions)
CONC 8	Debt advice
CONC 9	Credit reference agencies
CONC 10	Prudential rules for debt management firms
CONC 11	Cancellation
CONC 12	Requirements for firms with interim permission for credit-related regulated activities
CONC 13	Guidance on the duty to give information under sections 77, 78 and 79 of the Consumer Credit Act 1974
CONC 14	Requirement in relation to agents
CONC 15	Second charge lending
CONC Transchedule	Transitional provisions and schedules

### Carrying across CCA rules

- 5.3** Various provisions of the CCA and its secondary legislation are being repealed<sup>2</sup> on the basis that these will be replaced by FCA rules from 1 April 2014. We are now consulting on these rules in Appendix 2.
- 5.4** CONC includes notes setting out where a rule is derived from, where appropriate.

**Table 5.2 – the relevant CCA provisions, and their FCA counterparts**

<b>CCA provision</b>	<b>Corresponding FCA provision</b>
section 51 CCA (prohibition of unsolicited credit-tokens)	CONC 2.9
sections 51A and 51B (restrictions on provision of credit card cheques and exemption for business)	CONC 4.1.1
section 55A (pre-contractual explanations etc.)	CONC 4.3.5
section 55B (assessment of creditworthiness)	CONC 5.2 and 6.2
sections 74A and 74B (current account overdrafts)	CONC 4.8 and 6.3
section 81 (appropriation of payments)	CONC 6.4
section 82A (assignment of rights)	CONC 6.5
section 115 (penalty for failure to supply copies of pledge agreements etc)	CONC 6.6.2
section 160A (credit intermediaries)	CONC 3.7.5 and 4.5

<sup>2</sup> Most of the conduct-related provisions in the CCA and its secondary legislation will remain in place after the transfer. The provisions of the CCA which are being repealed are in article 20 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No2) Order 2013 (S.I. 2013/1881). The secondary legislation which is being revoked is set out in article 21 of that Order.

CCA provision	Corresponding FCA provision
Consumer Credit (Conduct of Business) (Credit Reference) Regulations 1977	CONC 2.2.4 and 2.5.5 – 2.5.7
Consumer Credit (Conduct of Business) (Pawn Records) Regulations 1983	CONC 6.6.3 – 6.6.8
Consumer Credit (Content of Quotations) ... Regulations 1999	CONC 4.2
Consumer Credit (Advertisements) Regulations 2010	CONC 3.5
Consumer Credit (Advertisements) Regulations 2004	CONC 3.6

- 5.5** We have not substantially changed the relevant CCA provisions. We propose to impose similar provisions in relation to pre-contractual explanations and creditworthiness to cover operating an electronic system for lending (peer-to-peer lending see Chapter 8).

### Carrying across OFT guidance

- 5.6** In March we consulted on the principle of turning certain OFT guidance into FCA rules and guidance. We explained that we intended to substantially replicate the guidance in a way that means that firms already complying with it are unlikely to need to change their behaviour.
- 5.7** We have now considered the OFT guidance documents in detail and propose making guidance into rules where we think it is appropriate and necessary. In other cases we have taken the view that it is more appropriate to have guidance indicating that particular behaviour is likely to be a breach of a rule (for example a rule in the Principles for Businesses (PRIN<sup>3</sup>)) or that other guidance is appropriate.
- 5.8** We list the relevant OFT guidance below, highlighting key issues. You can see the detailed rules in Appendix 2. We have referred to the OFT guidance in CONC where possible.
- 5.9** The specific areas where we are carrying across OFT guidance and would welcome feedback are:
- **Irresponsible lending – OFT guidance for creditors** – we would welcome feedback in particular on our proposals in relation to explanation of credit agreements (CONC 4.3), assessment of affordability (CONC 5.2), pre-contractual issues, post-contractual issues (CONC 6) and handling of default and arrears handling (CONC 7).
  - **Mental capacity** – we have carried across a shortened version of the mental capacity – *OFT avoidance for creditors* guidance into FCA rules (CONC 2.10).
  - **Credit brokers and intermediaries** – we would particularly welcome comments on CONC 2.5.8 and 2.5.9. relating to unfair business practices in relation to credit broking.

<sup>3</sup> See Part B – Policy statement on the high-level rules we consulted on in CP13/7.

- **Debt collection – guidance for businesses engaged in the recovery of consumer credit debts** – we would particularly welcome feedback on outsourced tracing and continuous payment authorities (CONC 7.6 and 7.14).
- **Debt management (and credit repair services) guidance** – we would particularly welcome feedback on rules and guidance applied to firms in their dealings with lead generators; and rules and guidance derived from debt management protocol (CONC 2.6.2 and 8.7.2).
- **Misleading or otherwise undesirable names guidance** – we have carried across the core elements of this guidance at CONC 2.2.3 to 2.2.5.
- **Second charge lending – OFT guidance for lenders and brokers** – we would particularly welcome feedback on our proposed policy for second charge lending (CONC 15).
- **Guidance on Sections 77, 78 and 79 of the CCA – the duty to give information to debtors and the consequences of non-compliance on the enforceability of the agreement** – we have carried this across at CONC 13.

**5.10** Areas where we have decided not to carry across guidance include:

- **The post-contract information requirements – Consumer credit act 1974 – Post – contract information requirements** – we have decided not to carry across this guidance as it is merely a plain language summary of the legislation.
- **Payment Protection Products FSA and OFT Joint Guidance** – We have decided not to incorporate the OFT elements of this guidance into FCA rules at this time, as they are largely just an elaboration of other OFT guidance (in particular, the irresponsible lending guidance). The FSA chapter of the joint guidance will continue to apply, but the OFT chapter will cease to apply from 1 April. However, firms offering CCA regulated payment protection products will be subject to PRIN, other high-level rules and CONC. The document may be reviewed in future in the light of developments in the market.

**Q7: Do you have any comments on how we propose to carry across CCA and OFT standards, in particular in the areas highlighted above?**

### New proposals for financial promotions

- 5.11** In March we said we would consult on financial promotions<sup>4</sup> rules that reflect our approach to other regulated activities, but that we may consider new rules where there is evidence of harm being caused to consumers.
- 5.12** In response to feedback from our March consultation, we have decided to create rules for financial promotions that more closely reflect existing standards to minimise the impact of the change for most firms as far as possible and to maintain a high level of consumer protection.

<sup>4</sup> Financial promotions are communications including advertisements which contain an invitation or inducement to a consumer to buy regulated services or products.

**5.13** We propose to:

- require firms to comply with the high-level principle that a communication or financial promotion is clear, fair and not misleading and certain other rules and guidance that apply to the other FSMA financial promotion regimes
- create rules for consumer credit firms that are broadly equivalent to the current CCA advertising rules, which implemented the Consumer Credit Directive (CCD) requirements and those that apply to agreements secured on land
- carry across the relevant OFT guidance as FCA rules and guidance

**5.14** These rules will not, however, apply to promotions and communications covering second charge loans by firms that also carry on first charge residential lending (qualifying credit).

**5.15** The high-level principle to be clear, fair and not misleading in financial promotions provides the backbone to our approach. As firms will be required to comply with PRIN and the Consumer Protection from Unfair Trading Regulations (CPRs); this should not impose a further burden on them.

**5.16** Inevitably, there are some differences between the current CCA regime and our proposed rules. For instance, we have included key parts of the guidance published by the Department for Business, Innovation and Skills on the Consumer Credit Advertisement Regulations (CCAR). In a few places we have clarified what is clearly intended by provisions of CCAR, for example, we have clarified regulation that an incentive that will trigger the requirement to include an APR in an advert includes, but is not limited to, statements about speed of granting credit. We have also introduced a limited exemption from the financial promotions rules for image advertising.

**5.17** Financial promotion requirements for firms providing second charge loans will remain similar to current requirements until they transfer to the longer-term mortgage regime.<sup>5</sup>

#### **Financial promotions for high-cost short-term credit, cold calling and debt management companies**

**5.18** In March we said that we might consider new financial promotions rules in areas of potential harm to consumers. We are now proposing to introduce a new risk warning for high-cost short-term credit (see Chapter 6 for more details).

**5.19** We propose to reflect the OFT guidance on cold-calling and other unsolicited marketing activities and to align it with our other financial promotions regimes. We propose to require firms to identify themselves and the purpose of the communication and to make sure it is at an appropriate time of day. We expect firms to be complying with this already, so this should not have a significant impact on working practices or costs. Although we do not propose to ban cold-calling immediately, we may consider this further in future.

**5.20** We propose to ban the approval of a financial promotion to be made in the course of a personal visit, telephone conversation or other interactive dialogue. The effect will be to prevent non-authorised firms from engaging in these activities. We expect this to have a minimal impact on working practices or costs, but we would welcome feedback on this.

<sup>5</sup> The financial promotion rules here will not apply to a promotion about qualifying credit. Where a promotion is partly about qualifying credit and partly not, these rules apply to the non-qualifying credit.

- 5.21** For financial promotions or communications by debt management companies, we have turned the standards set out in the OFT debt management guidance into rules and guidance as appropriate. For example, there is now a rule that makes it clear that debt management companies must not pass themselves off as a charitable, not-for-profit body, government or local government organisation.
- 5.22** Although we cannot apply rules to firms that generate sales leads for debt management firms (where they do not carry on regulated activity), we are proposing rules and guidance for debt management firms covering these relationships, which reflect the requirements of the OFT debt management guidance. This includes a rule requiring debt management firms, before they accept leads, to take reasonable steps to ensure that the lead generators' websites and financial promotions comply with legal requirements.
- 5.23** As our proposed rules mostly reflect the current standards, the impact of any changes on firms should be limited. So we propose to apply the same six-month transitional period to financial promotions that apply to other conduct of business requirements. During this period, we will not take enforcement action based on new rules, as long as the firm in question can demonstrate that it was previously compliant with the corresponding CCA requirement or OFT guidance.

**Q8: Do you have any comments on our proposed approach to financial promotions?**

**New proposals for industry codes**

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- 5.24** The current consumer credit regime is supported by a wide variety of industry codes. These codes are usually sponsored by trade associations.
- 5.25** Industry codes can be helpful in translating how regulatory requirements can be adopted in particular industry sectors.
- 5.26** In March we noted two issues that would affect our approach to industry codes:
- Compliance with many industry codes is not independently monitored, and after the transfer we will not rely on third parties to monitor compliance with our rules
  - Some code provisions demand higher conduct standards from firms than the current legal and regulatory regime
- 5.27** As a result of feedback from our March consultation, we have decided to adopt certain elements of industry codes as FCA rules on a case-by-case basis. Where we believe that a particular code provision is important to ensure consumer protection and is appropriate to our supervision and enforcement processes, we propose to incorporate it into our rules.

**5.28** For example, we are consulting on draft rules incorporating aspects of the Debt Management Protocol, which requires a debt management firm to:

- tell a customer in its first written or oral communication that free debt advice is available and that the customer can find out more by contacting the Money Advice Service (see CONC 2.6.2)
- recover its costs in a way that does not prevent significant repayments being made to a customer's creditors from the first month of a debt management plan and every month during the course of the plan (see CONC 8.7.2).<sup>6</sup>

### When will the rules apply?

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**5.29** We propose for our rules to come into force on 1 April 2014. We have tried to make the transfer as smooth as possible for the vast majority of firms, and do not expect many firms to need to make significant changes to their systems.

**5.30** However, we want firms to have time to get accustomed to the new structure and style of CONC, so we propose a six-month period from 1 April 2014, in which we will not take enforcement action based on the new rules, as long as the firm in question can demonstrate that it is compliant with the corresponding CCA requirement or OFT guidance.

### High-level rules

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**5.31** In FSA CP13/7 we consulted on our high-level rules, including PRIN, SYSC and GEN. We have now made these rules, with one change in relation to status disclosure. Details of the rules and feedback received can be found in Part B to this paper.

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<sup>6</sup> This does not preclude firms from operating a full and final settlement business model. The rule prevents borrower repayments not being made to creditors from month one of a debt management plan because the borrower's initial repayment or repayments are being retained by the debt management firm in their entirety or in large part to cover its set up costs i.e. the initial repayments are being retained as an 'upfront fee'.

## 6. Proposed rules for high-cost short-term credit, including payday loans

The high-cost short-term credit sector is estimated to serve around two million customers and is worth an estimated £2.0 to £2.2 billion in 2011/12, up from an estimated £900 million in 2008/09,<sup>1</sup> at a time when some UK households face severe financial pressures.

There is considerable evidence from stakeholders, including consumer groups that consumers continue to experience very poor outcomes in this sector. Citizens Advice reports that one in three complaints to them in the first half of this year was about Continuous Payment Authorities (CPAs). The recent Office of Fair Trading compliance review<sup>2</sup> found that across the sector firms were lending irresponsibly and engaged in business practices that harm consumers. This report tells us that last year 28% of payday loans were rolled over.

In our March consultation paper we said we would consult on amending or adding new rules where we identified risks for consumers. So in this chapter we propose new rules for high-cost short-term lenders to help improve outcomes for consumers and address the issues being caused by harmful business practices.

Our proposals have two main aims:

- To ensure that firms only lend to borrowers who can afford it – the caps on rollovers and CPAs should help by making it difficult for businesses to base their models on unaffordable borrowing and reduce the incentive to lend to borrowers who cannot afford the loan.
- To increase borrowers' awareness of the costs and risks of borrowing unaffordably, and ways to get help if they have financial difficulties.

<sup>1</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg146

<sup>2</sup> Office of Fair Trading, *Payday Lending Compliance Review Final Report*, 2013

## Tackling problems in this market

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- 6.1** In recent years, the Government and the OFT have responded to problems identified in the high-cost short-term credit market through guidance or encouraging voluntary agreements. Scrutiny of this market has intensified with the OFT's compliance review of payday lending and the Government commissioning academic research into possible interventions, such as capping the cost of credit. However, the problems persist.
- 6.2** The OFT review found that across the sector firms were not complying with their legal requirements, which has caused real harm to consumers, and this is backed up by consumer groups. For example, between January and June 2013, StepChange, a debt charity, helped 30,762 people with payday loan debts, compared to 36,413 for the whole of 2012.<sup>3</sup>
- 6.3** In their research, Europe Economics<sup>4</sup> found evidence from a range of sources of problematic practices that are harming consumers, such as:
- lenders not carrying out adequate affordability assessments
  - common business practice to roll over loans
  - using CPAs to secure unaffordable payments from borrowers
  - using CPAs to bombard consumer's accounts with payment requests
  - giving unsuitable advice and not offering sufficient forbearance to consumers facing repayment difficulties
  - using aggressive debt collection practices
- 6.4** The Government's decision to transfer consumer credit to the FCA intends to deliver better outcomes for consumers. The OFT referred the payday lending sector to the Competition Commission (CC) in June this year. The CC expects to publish its final report towards the end of 2014.
- 6.5** From 1 April 2014, we will have extensive powers to take action in this market where there is evidence of firms not treating customers fairly. However, taking action against individual firms will not on its own address the wider problems in this market. We therefore propose a range of new measures to address the immediate issues in this market. We will continue our own further work while also awaiting the outcome of the CC's work with interest.

## The changes we propose

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- 6.6** The changes we propose include creating new rules:
- Limiting the number of times a high-cost short-term credit loan can be rolled over to two.
  - Introducing a limit of two unsuccessful attempts on the use of CPAs to pay off a loan and a ban on part payments.

<sup>3</sup> <http://www.stepchange.org/Mediacentre/Pressreleases/Paydayloansfurtheractionneeded.aspx>

<sup>4</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, from pg149

- Requiring a risk warning on all high-cost short-term credit adverts, which will come within our financial promotions rules.<sup>5</sup>
- Requiring high-cost short-term credit providers to provide an information sheet, including information on free debt advice, before a loan is rolled over.

**6.7** These rules will apply to high-cost short-term credit lenders only.

### The impact of our proposals

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**6.8** Our proposals have two main aims:

1. To ensure that firms only lend to borrowers who can afford it – the caps on rollovers and CPAs should help by making it difficult for businesses to base their models on unaffordable borrowing and reduce the incentive to lend to borrowers who cannot afford the loan.
2. To increase borrowers' awareness of the costs and risks of borrowing unaffordably, and ways to get help if they have financial difficulties.

**6.9** In considering the effectiveness of potential interventions, we have used data on the UK market. This includes data collected by the OFT during its compliance review and information that is publicly available, including the University of Bristol's Personal Finance Research Centre report on high-cost credit and data provided by stakeholders. We have also engaged with regulators from other jurisdictions, reviewed academic studies on the effectiveness of policy interventions in those jurisdictions and drawn on our own experience of regulating the secured lending market.

**6.10** We strongly believe as a matter of common sense, wide-ranging evidence and our experience as a regulator that it is generally better for borrowers to borrow affordably. We also believe that this is grounded in a reasonable belief that borrowing unaffordably leads to debt spirals and consumer harm from debts that cannot be repaid. With the OFT finding 28% of loans are rolled over there is clearly a problem to address.

**6.11** In developing these proposals, we considered how we can best secure the appropriate degree of protection while minimising the impact on firms or competition. We have considered a number of options that offer differing outcomes in terms of either effectiveness or intrusiveness on firms. We have concluded that none could achieve the same targeted impact on unaffordable lending as our package of proposals.

### The application of our proposals

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**6.12** The common term for high-cost short-term products is 'pay day loans'. In our definition we have chosen not to use this term, because it refers to a specific practice of paying back when a borrower is next paid. Our wide definition of a high-cost short-term credit product tries to capture the fundamental business model currently in the market. While many borrowers do pay back the loan on the following payday, borrowers are able to borrow for shorter or longer periods. There is also a trend for lenders to develop longer-term high-cost products that are repaid over several months.

<sup>5</sup> These are set out in CONC 3.

- 6.13** We have also tried to future-proof the definition, to prevent or capture any attempts by firms or their advisors to ‘game’ the protections we are proposing by defining their product outside the scope of our definition. This touches on a wider concern we have that firms will adapt their product in light of our measures to increase revenue through other means, such as increasing the term of their loans that may not be beneficial to consumers in the long run.

### Updates to our Handbook

High-cost short-term credit is proposed to be a definition in the Glossary of the Handbook:

‘a regulated credit agreement:

- which is a borrower-lender agreement or a P2P6 agreement;
- in relation to which the APR is equal to or exceeds 100%;

either:

- i. in relation to which a financial promotion indicates (by express words or otherwise) that the credit is to be provided for any period up to a maximum of 12 months or otherwise indicates (by express words or otherwise) that the credit is to be provided for a short term; or
  - ii. under which the credit is due to be repaid or substantially repaid within a maximum of 12 months of the date on which the credit is advanced;
- which is not secured by a mortgage, charge or pledge; and

which is not a home credit loan agreement, a bill of sale loan agreement or a borrower-lender agreement enabling a borrower to overdraw on a current account or arising where the holder of a current account overdraws on the account without a pre-arranged overdraft or exceeds a pre-arranged overdraft limit.’

### **Q9: Do you agree with the definition of a high-cost short-term credit provider as set out at the start of this chapter?**

- 6.14** Given the harm to consumers identified as a result of business practices in this market, we are keen to introduce reforms as soon as we acquire our new powers on 1 April 2014. However, we recognise that firms will need time to adjust their business practices once we confirm our final rules. Therefore the requirements on CPAs, rollovers, and warnings on non-electronic communications would only come into effect on 1 July 2014; this allows lenders a three-month transitional period.
- 6.15** We are also moving large sections of the OFT affordability guidance into FCA rules.
- 6.16** We are interested in hearing your views on what we propose, and the potential impact that you think the changes could have. Our consultation questions on our proposals for the high-cost short-term credit firms can be found at the end of this chapter.

<sup>6</sup> Peer-to-peer lender.

**Table 6.1 – A summary of our proposals**

Proposal	Implementation date
Transpose OFT affordability guidance into FCA rules and guidance to make it a binding requirement for firms to only lend where a loan is affordable. Firms must only refinance a loan at the customer's request and where the firm reasonably believes it is in customer's best interests to do so. Transpose all rules on conduct standards, including financial promotions regime. <sup>8</sup>	1 April 2014.
Limit the number of times a high-cost short-term credit loan can be rolled over to two.	1 July 2014
Introduce a limit of two unsuccessful attempts on the use of CPAs to pay off a loan to give consumers in financial difficulty more control over their expenses. Prohibition on part payment requests.	1 July 2014
1) New rule requiring a risk warning on high-cost short-term credit financial promotions. 2) New rule requiring high-cost short-term credit providers to provide information on free debt advice before the point of rollover.	1) For any electronic communication <sup>2</sup> this rule will come into effect on 1 April 2014, while for all other adverts it will be on 1 July 2014. 2) 1 July 2014

### Adequate affordability assessments

- 6.17** The OFT compliance review found that the majority of lenders were not carrying out adequate affordability assessments of consumers when they apply for a loan. The Europe Economics' analysis of data collected by the OFT indicates that some firms' business models are based on making money from rollovers and default charges.<sup>9</sup>

#### Examples of poor affordability assessments:

**Citizens Advice:** A Citizen's Advice bureau in the Midlands reported the case of a young woman who was unemployed and received jobseeker's allowance (JSA) at the lower rate due to her age. She had been unable to find full-time work and had accumulated debts of approximately £1,700 that she could not afford to repay on her low income. She contacted a payday lender to ask for a payday loan and told them that her only income was JSA of around £200 per month. The company gave her a loan of £200, which she then struggled to repay.

<sup>7</sup> This is discussed in detail in Chapter 7

<sup>8</sup> This covers emails, online, and SMSs.

<sup>9</sup> Europe Economics' statistical analysis of data collected by the OFT suggests that large firms rely more on revenue from rollovers, whilst smaller firms obtain significant revenues from late repayment fees, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 152

**StepChange:** The charity recently advised a client with severe mental and physical health problems. Despite the client's only income coming from employment and support allowance and disability living allowance, he was able to take out eight loans with five separate companies. These loans have been rolled over multiple times, adding significantly to the debt. For example, one company has rolled over the debt each fortnight for a year, at a cost of £10 per rollover. This has had a severe impact on his stress levels.

- 6.18** Under the Consumer Credit Directive (CCD) we have to require lenders to assess the creditworthiness of a customer before entering into a credit agreement with them. This requires lenders to gather enough information from the borrower and, where necessary, a credit reference agency to carry out their assessment. The OFT guidance supplements this by setting out standards on assessing affordability. Part of the OFT guidance on affordability supports the CCD concept of creditworthiness, so we propose to transpose the relevant parts of the OFT guidance on affordability into FCA rules. We propose to include rules to require lenders to consider the customer's ability to repay the loan and the potential for the loan to have an adverse impact on the consumer's financial situation. Furthermore, our rules will mean that loans can only be extended where the customer has agreed to the extension and only after the lender is satisfied that it is in the customer's best interest to do so. These rules will apply to all regulated credit lending.
- 6.19** Our proposals aim to strengthen consumer protection and are based on the principle that money should only be lent to a consumer if the consumer has the ability to repay and in a sustainable way.

### Updates to our Handbook

5.2.1(R)<sup>10</sup>(1) Before making a regulated credit agreement the firm must undertake an assessment of the creditworthiness of the customer.

(2) A firm carrying out the assessment required in (1) must consider:

- a. the potential for the commitments under the regulated credit agreement to adversely impact the customer's financial situation, taking into account the information of which the firm is aware at the time the regulated credit agreement is to be made; and
- b. the ability of the customer to make repayments as they fall due over the life of the regulated credit agreement, or for such an agreement which is an open-end agreement, to make repayments within a reasonable period.

5.2.2(R) (2) The extent and scope of the assessment required by CONC 5.2.1R or by (1), in a given case, is dependent upon and proportionate to factors including the following:

- a. the type of credit;
- b. the amount of credit;

<sup>10</sup> (R) indicates that the provision is proposed as a rule in the FCA Handbook.

- c. the cost of credit;
- d. the financial position of the customer at the time of seeking the credit;
- e. the customer's credit history, including any indications that the customer is experiencing or has experienced financial difficulties (to the extent the firm is aware of the credit history);
- f. the customer's existing financial commitments including any repayments due in respect of other credit agreements, consumer hire agreements, regulated mortgage contracts, payments for rent, council tax, electricity, gas, telecommunications, water and other major outgoings known to the firm.
- g. any future financial commitments of the customer of which the firm is aware, having taken reasonable steps to obtain that information;
- h. any future changes in circumstances which could be reasonably expected to have a significant financial adverse impact on the customer of which the firm is aware, having taken reasonable steps to obtain that information;
- i. the vulnerability of the customer, in particular where the firm understands the customer has some form of mental capacity limitation or reasonably suspects this to be so because the customer displays indications of some form of mental capacity limitation (see CONC 2.10).

6.7.19 (R) A firm must not refinance a customer's existing credit with the firm (other than by exercising forbearance), unless:

- a. the firm does so at the customer's request or with the customer's consent; and
- b. the firm reasonably believes it is in the customer's best interests to do so.

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### Cap on rollovers

**6.20** As noted above, last year 28% of high-cost short-term credit loans were rolled over.<sup>11</sup> It is more common for larger lenders to roll over a loan, however, smaller lenders are more likely to add default charges.<sup>12</sup> Rollovers are a simple and easy process for the borrower, but the costs to them can be significant. Citizens Advice reported that 83% of firms did not make borrowers already in difficulty aware of the risks and costs of rolling over the loan.<sup>13</sup>

<sup>11</sup> OFT, *Payday Lending Compliance Review Final Report*, p2

<sup>12</sup> Europe Economics' statistical analysis of data collected by the OFT suggests that large firms rely more on revenue from rollovers, whilst smaller firms obtain significant revenues from late repayment fees, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 152

<sup>13</sup> [www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_20130528.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20130528.htm)

### Updates to our Handbook

6.7.17 (R) (1) In CONC 6.7.18R to 6.7.23R 'refinance' means to:

- a. extend the period over which one or more repayment is to be made by a customer; or
- b. change the date on which one or more repayment to be made by a customer is due (or expected) to a later date; or
- c. purport to do either (a) or (b),

by agreeing with the customer to replace, vary or supplement an existing regulated credit agreement or by exercising a contractual power under an existing regulated credit agreement or otherwise.

(2) 'exercise forbearance' means to refinance a credit agreement where the firm does not receive any consideration in connection with refinancing and the effect is that no interest or other charges (other than where a charge is a reasonable estimate of the cost of the additional administration required as a result of the customer having refinanced the agreement) accrue from the date of refinancing.

**6.21** US academic research into consumer behaviour helps explain why so many borrowers do not pay in full at the end of their monthly loan term. This research<sup>14</sup> indicates that consumers underestimate the risk or simply do not believe they will not be able to repay the loan on time, so they do not consider the risks and costs of that happening. This makes it easier for a lender to structure its business model in a way that relies on loans being rolled over, or default charges being added, and not on the borrower's ability to repay on time.<sup>15</sup> Furthermore, Europe Economics found that it might not be in a lender's interests to conduct adequate affordability checks, e.g. checks are time-consuming and expensive or there may be insufficient information to conduct an adequate assessment in any event.<sup>16</sup>

**6.22** Despite this, we know that consumers want some flexibility where things may have gone wrong, such as not being paid the expected amount on the expected day. In some circumstances, rolling over a loan can help the consumer because this means they will not default on the loan, and therefore will not have to pay additional fees and charges, or negatively affect their credit score.

<sup>14</sup> Rollover, Rollover: A Behavioural Law and Economics Analysis of the Payday Loan Industry, (Karen E. Francis) Texas Law Review [Vol. 88:611]

<sup>15</sup> Europe Economics' statistical analysis of data collected by the OFT suggests that large firms rely more on revenue from rollovers, whilst smaller firms obtain significant revenues from late repayment fees, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 152

<sup>16</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 153

### Classifications of Payday consumers<sup>17</sup>

'Low-risk borrowers': easy access to mainstream credit and coping comfortably. Lower income than other payday users. No adverse credit history, but prefer payday loans as wary of revolving credit and overdraft models. Likely to have a more considered approach to lending. Make rational payday choices and less likely to be influenced by biases such as optimism or be hasty and value speed over cost. Probably have no problem getting or repaying payday loan.

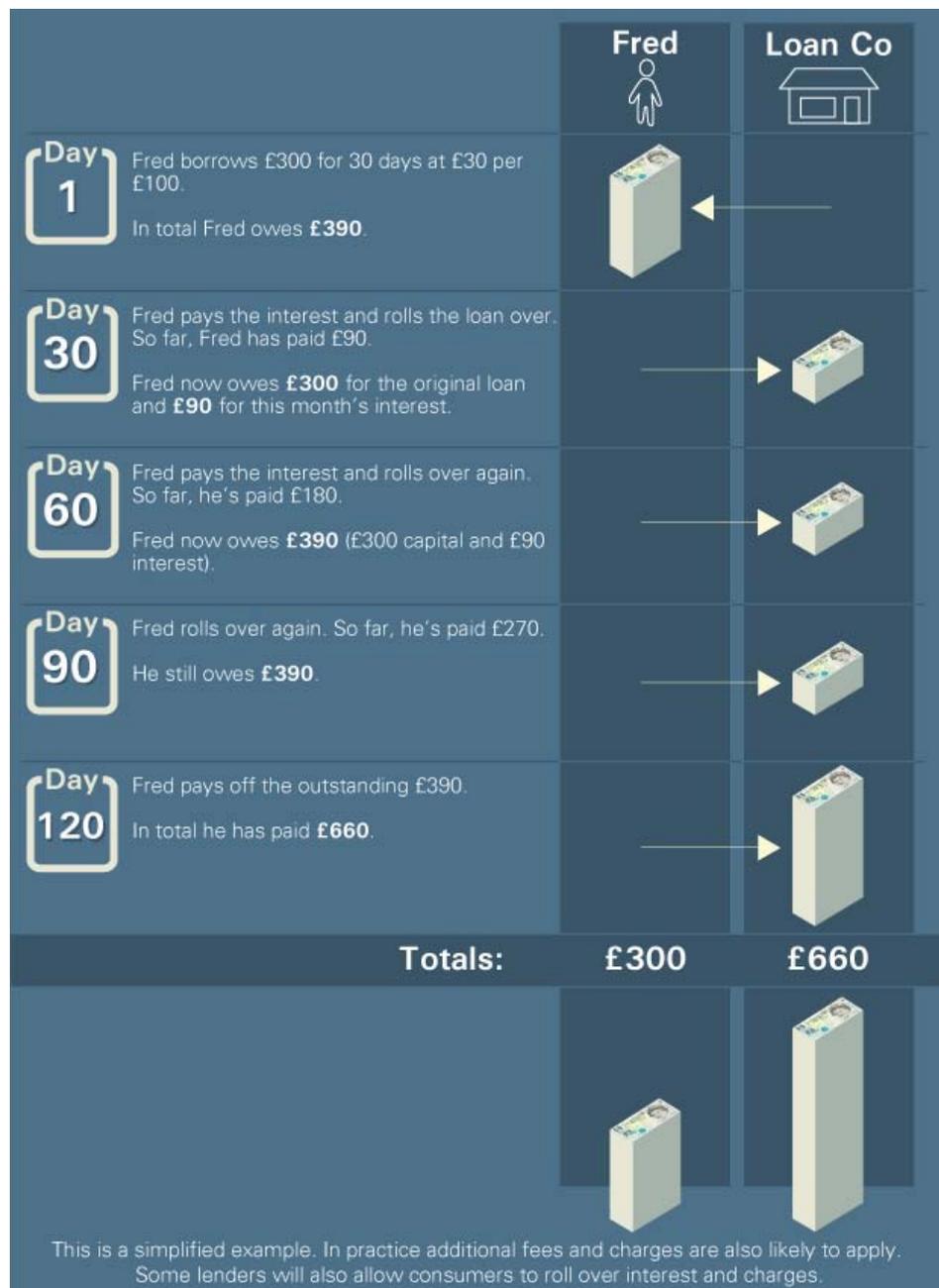
'Moderate-risk borrowers': maxed out credit cards and minimum payments and increasing credit refusals, payday seen as safer, and also potentially cheaper, than revolving credit. Often relatively high income and less critically credit dependent. Have potential to escalate credit card debt, although poor credit rating from low-level delinquency. These could be those who could 'do without' if no access to payday lending. Affordability assessments that just look at income would probably classify these consumers as able to repay loans. However, these are classified as having increasing credit refusals and poor credit rating from low-level delinquency. CRA checks may therefore be less forgiving.

'High-risk borrowers': finances finely balanced and credit dependent, payday critical to managing credit flow and commitments. These users correspond most closely to the profile of those most likely to become enmeshed in long-term mainstream credit debt traps. Critically dependent on cycling credit to make ends meet (payday lending playing a role in this). Large proportion of these unlikely to have other credit options – 45% can no longer borrow elsewhere.

- 6.23** Europe Economics estimate that 34% of payday borrowers are 'high-risk borrowers'.<sup>18</sup> This group are dependent on credit to make ends meet, and may have no alternative credit options. A significant section of borrowers therefore are at risk of becoming trapped in debt due to the costs of rolling over. The following example demonstrates how quickly the cost of a high-cost short-term credit loan can spiral out of control.

<sup>17</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 165

<sup>18</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 165

**What happens when a loan is rolled over?**

Source: Office of Fair Trading, *Payday Lending Compliance Review Final Report*, 2013

- 6.24** This simplified example clearly shows that the benefits of continued flexibility diminish quickly. By the second rollover, Fred owes almost twice the amount he borrowed. We are concerned that excessive rollovers can hide financial difficulty and can lead consumers' debt to spiral out of control. Unless a rollover is a response to a brief reduction in a borrower's income, postponing repayment and incurring further costs in the process is likely to make the borrower's situation worse and reduce their ability to repay the loan at a later date. In these cases, it is probably more appropriate for them to enter into a repayment plan with their lender.

- 6.25** Yet the information we have received from consumer groups suggests firms are not doing this. Citizens Advice found lenders are failing to help customers when they have difficulties repaying the loan. Their survey found that 84% of borrowers who had repayment problems were not offered the chance to freeze interest and charges and offered a repayment schedule and, as we referred to earlier, none were telling their customers about the free debt advice available.<sup>19</sup> The OFT compliance review strongly suggested that many lenders continue to carry out inadequate affordability checks.

#### Case study on rollover

**StepChange:** They advised a woman with a debt management plan (DMP) with a for-profit debt management company. While on the DMP her income fell sharply after she left work on maternity leave. She attempted to maintain payments by taking out payday loans with multiple lenders, who allowed her to borrow money despite the fact they knew she was on a DMP and was on maternity leave. Where she was not able to repay the loan on time, lenders rolled over the debt several times, which resulted in a total debt of £6,000.

- 6.26** The industry has recognised the negative effects of rollovers on consumers. Under the Consumer Finance Association Code of Conduct, which covers part of the industry, their members are only permitted to roll over three times.<sup>20</sup>
- 6.27** But we don't think this goes far enough. As the number of rollovers increases, the likelihood that a borrower is simply facing a temporary change in circumstances, where a further rollover could help, diminishes. The more likely explanation when a borrower has to extend a loan for more than one period, and certainly for more than two, is that the individual is in financial difficulty. We take this view because a borrower who has extended the loan for more than one period has already failed to repay the loan as expected on at least two occasions despite providing adequate evidence of their ability to repay, and because the effect of each rollover is that the borrower's debt burden is significantly increased.
- 6.28** Given that the finances of customers who take out payday loans are often finely balanced (the Bristol Report found that 41% to 46% of high-cost short-term credit customers showed signs of financial stress in the last 12 months<sup>21</sup>), the more likely explanation is that the individual is in financial difficulty. Where this is the case, under standards that we are transposing from OFT guidance, the lender is required to treat the customer with forbearance and consider entering into a repayment schedule.

<sup>19</sup> [www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_20130528.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20130528.htm)

<sup>20</sup> [www.cfa-uk.co.uk/assets/files/CFA%20Lending%20Code%202012.pdf](http://www.cfa-uk.co.uk/assets/files/CFA%20Lending%20Code%202012.pdf) Rule 4.6.4.

<sup>21</sup> Personal Finance Research Centre, University of Bristol *The impact on business and consumers of a cap on the total cost of credit 2013 Bristol Report*, pg iii.

We are consulting on a maximum of two rollovers.

### Updates to our Handbook

6.7.23 (R) A firm must not refinance high-cost short-term credit (other than by exercising forbearance) on more than two occasions.

- 6.29** We have considered the possibility of a cap by which a high-cost short-term loan must be paid off, for example, at 60 days after the due payment, given that the average loan length for high-cost short-term credit is 30 days.<sup>22</sup> We do not have sufficient data at the moment to understand the effect on access to credit, but we would welcome your views on any mechanism we could put in place to future-proof consumer protections in this market.
- 6.30** We would be interested to hear further evidence from firms, consumer groups and consumers, especially whether one rollover may be a more appropriate cap to prevent escalating costs. At this stage, we are concerned that one rollover could overly restrict access to credit for some borrowers for whom it may be ultimately affordable.<sup>23</sup>

**Q10: Do you have any comments on limiting rollover to two attempts?**

**Q11: Do you have any comments on whether one rollover is a more appropriate cap?**

### Cap on the number of CPA attempts

CPA use is widespread in the high-cost short-term lending market. We understand that CPAs are the main collection instrument for online lenders, but not necessarily for high-street lenders, with smaller stores the least likely users. According to the data collected by Policis, six out of eight online high-cost short-term lenders they contacted collect at least 85% of their loans via CPA. Three lenders collect 100% of their loans this way.

### What is a CPA?

Continuous payment authorities (CPAs) can provide an efficient and convenient payment method for customers.

Once agreed by a customer, a CPA allows a business to take a series of payments from a customer's account. CPAs are often used to collect renewal payments for things like vehicle breakdown services, insurance policies, gym memberships, online dating, mobile and broadband services or magazine subscriptions.

In the case of high-cost short-term credit, CPAs are used to collect payment usually on the client's next pay day.

<sup>22</sup> Office of Fair Trading, *Payday Lending Compliance Review Final Report*, 2013

<sup>23</sup> According to Policis / Toynbee Hall report in our CBA, 41% may find credit affordable but suffer from poor credit scores due to credit refusals and poor credit ratings. This group could suffer from a reduction in the supply of credit. Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 148

- 6.31** In November 2012, the OFT introduced new guidance on CPAs to encourage lenders to support consumers in financial distress. This set out the OFT's expectation that lenders should make contact with the consumer after the end of the second day of attempting to take payment, establish the reasons for non-payment and suspend collection until they have contacted the borrower to establish whether they are in financial difficulty. Despite this, it remains common practice for lenders to repeatedly place requests to borrowers' bank accounts in the hope of maximising the recovery of their loans. These requests vary in their amount and timing, but it is clear that the aim is to obtain funds from the account as soon as they become available. Europe Economics found that lenders were behaving in this way to identify the amount and the timing of arrival of funds into the borrower's account and to collect them as soon as they are available to maximise the recovery of loans.<sup>24</sup> They also remove considerable incentives for the firms to lend responsibly if the continuous use of CPAs can be used in effect as a debt collection method.
- 6.32** Consumer groups have reported to the FCA the problems they have seen with CPAs. Citizens Advice report that one in three complaints to them in the first half of this year was about CPAs and 90% had grounds for a complaint to the Financial Ombudsman Service (the ombudsman).<sup>25</sup> Stepchange has detailed a number of problems, including lenders ignoring debt management plans.<sup>26</sup>
- 6.33** The ombudsman has also seen a sharp rise in complaints on CPAs, up 75% this year concerning short-term high-cost loans, and they find in favour of the consumer around three quarters of the time. Typical problems they see involve payday lenders trying to take payments unexpectedly – or repeatedly attempting to take payments when the consumer has already explained that they do not have enough money to cover the debt.<sup>27</sup>
- 6.34** There is already significant research showing that losing control of their bank account is a major cause of stress and anxiety for some consumers.<sup>28</sup> The Financial Inclusion Taskforce has shown the financial impact a loss of control can have around automated payments.<sup>29</sup> While there are no direct costs from missing a CPA (unlike a Direct Debit), the lack of funds available for food, heating or other more pressing bills following repeated part payments can lead to additional costs and anxiety for consumers.<sup>30</sup>

<sup>24</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, p149

<sup>25</sup> [www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_office-newpage-20130903.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_office-newpage-20130903.htm)

<sup>26</sup> [www.stepchange.org/portals/0/Documents/media/reports/additionalreports/CCCS\\_response\\_OFT\\_supp\\_continuous\\_authority.pdf](http://www.stepchange.org/portals/0/Documents/media/reports/additionalreports/CCCS_response_OFT_supp_continuous_authority.pdf)

<sup>27</sup> [www.financial-ombudsman.org.uk/publications/ombudsman-news/109/109-payday-lending.html](http://www.financial-ombudsman.org.uk/publications/ombudsman-news/109/109-payday-lending.html)

<sup>28</sup> For example, [www.consumerfocus.org.uk/assets/1/files/2010/06/On-the-margins.pdf](http://www.consumerfocus.org.uk/assets/1/files/2010/06/On-the-margins.pdf)

<sup>29</sup> [http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/fin\\_inclusion\\_taskforce\\_poorerhouseholds\\_dec2010.pdf](http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/fin_inclusion_taskforce_poorerhouseholds_dec2010.pdf)

<sup>30</sup> [http://www.socialfinance.org.uk/sites/default/files/SF\\_JamJarAccountReport\\_FULLREPORT.pdf](http://www.socialfinance.org.uk/sites/default/files/SF_JamJarAccountReport_FULLREPORT.pdf), Dearden, C, et al. Credit and debt in low-income families. Joseph Rowntree Foundation, 2010.

### Case study of misuse of CPA – Comments from CAB clients<sup>31</sup>

'I lost my job, and had to cancel my continuous payment authority with [the lender] and [the bank]. [The lender] then decided to steal money from my bank account, without my authorisation, stating they have card details and can do as they wish, and that they do not enter into repayment plans.'

'They kept taking money until the loan was repaid, constantly taking it until repaid, even though I had made agreements they carried on taking them anyway.'

'They tell you to wait until your due date and default, which means you have the stress of either arranging for wages to be paid into a different account if it's not too late or cancel the CPA and hope for the best, and you still have the worry that they will still somehow find a way to clear your account before a repayment plan is agreed. Which is I might add what happened to myself just last week.'

- 6.35** As noted by Europe Economics, given the widespread use of CPAs, it is logical to assume that lenders find them effective and preferable to repayment plans, either because they give a higher recovery rate or because it is cheaper for them. This payment method also allows lenders to have access to funds received in a bank account first, which is another factor that could undermine our efforts to ensure high-cost short-term lenders conduct adequate affordability assessments.
- 6.36** Work by the USA Federal regulator, the Consumer Financial Protection Bureau, supports these conclusions. Its in-depth review of the US payday lending market found that 'lenders may instead rely on their relative priority position in the repayment hierarchy to extend credit without regard to whether the consumer can afford the loan'.<sup>32</sup>

### What we propose

- 6.37** We believe the current model enables firms to lend to consumers without having carried out an affordability assessment. This is because CPAs enable lenders to obtain payment from borrowers who cannot afford to repay. Borrowers who get into difficulty may be more profitable for the firm from the additional charges and interest they incur, and the access a CPA offers allows firms to limit their collection costs and increase the amount repaid. So we believe that CPA repayments encourage insufficient affordability assessments and the unfair treatment of customers experiencing difficulties. We are not aware of any other credit industry where consumer's accounts are subject to such control by the lender to collect debt repayments.

<sup>31</sup> CAB Evidence: *Holding Payday lenders to account: half year results from Citizens Advice Payday loan survey*, July 2013 [www.glenda-jackson.co.uk/uploads/e8de37bc-61cf-d554-fdee-9f45c5be8d53.pdf](http://www.glenda-jackson.co.uk/uploads/e8de37bc-61cf-d554-fdee-9f45c5be8d53.pdf)

<sup>32</sup> [http://files.consumerfinance.gov/f/201304\\_cfpb\\_payday\\_dap-whitepaper.pdf](http://files.consumerfinance.gov/f/201304_cfpb_payday_dap-whitepaper.pdf)

- 6.38** But CPAs do offer certain flexibility for consumers and, if subject to appropriate controls, a measure of security for the lender. They are convenient, as payment does not rely on a manual transfer and, unlike Direct Debit, in most circumstances there are no charges for missed payments. CPAs also reduce the possibility that customers fail to make their payments due to unexpected circumstances.
- 6.39** While considering the right balance between consumer control and firm access, we have to make a judgement. We propose to introduce a limit of two unsuccessful attempts on the use of CPAs to pay off a loan (this includes where a firm refinances a loan). We believe this strikes the balance between giving consumers more control to manage their way out of financial difficulties, while maintaining some flexibility for the consumer and giving a measure of security for the lender. Together with our proposed limit of two rollovers, we believe the package reduces firms' ability to manage their credit risk without adequately assessing affordability.
- 6.40** Some commentators have argued that high-cost short-term lenders should only be allowed to make one attempt to take a payment via a CPA. We believe that it is reasonable to offer two CPA attempts so the lender can try again, for example a few days later, if the first attempt fails because the borrower has been paid late or has temporary cash-flow problems. If after two attempts there are still not sufficient funds in the account, this suggests that the consumer is experiencing financial difficulties. At that point the benefits of automatic payments are outweighed by the need to assess a borrower's circumstances.
- 6.41** We will also ban the use of CPAs to take part payments. This will reduce the potential harm caused to consumers by numerous part-payment attempts that take any funds available in borrowers' accounts.
- 6.42** A borrower in financial difficulty should know that the funds in their account are secure for priority expenditure. We do not think it is acceptable for firms to make repeated requests that could make the problem worse without discussing with the consumer the nature of, and potential solutions to, these problems. If we proposed any more than two CPAs, firms may still make arbitrary attempts to access funds that may not fit with a consumer's repayment needs. Our proposal will give consumers back control over their account.
- 6.43** We are particularly interested in the views and evidence from consumer groups, consumers and firms and their trade associations about our proposed approach, including any evidence of consumer harm as a result of CPA practices.

#### Updates to our Handbook

7.6.12 (R) (1) A firm must not give an instruction to a payment service provider requesting the execution of a payment from the customer's payment account for the purpose of collecting any sum owed for high cost short term credit following two unsuccessful attempts to collect the sum, in connection with the same high cost short term credit.

(2) For the purposes of (1):

- a. if high cost short term credit has been refinanced, except in exercise of forbearance, the agreement is to be regarded as the same agreement; and
- b. 'refinance' and 'exercise forbearance' have the same meaning as in CONC [6.7.17R].

(3) A firm must not in any case in relation to high cost short term credit give an instruction to a payment service provider requesting the execution of a payment from the customer's payment account for the purpose of collecting a sum less than the full amount due and payable at the time the instruction is given.

**Q12: Do you have any comments on our proposal to introduce a limit of two unsuccessful attempts on the use of CPAs to pay off a loan?**

**Q13: Do you have any comments on our proposal to ban the use of CPAs to take part payments?**

- 6.44** We have carefully considered the different ways we can help consumers to make informed choices when taking out high-cost short-term credit.
- 6.45** Research undertaken for the Department for Business, Innovation and Skills indicated that consumers did find total cost of credit easier to understand than Annual Percentage Rates (APRs).<sup>33</sup> We share their concern that APRs are confusing to consumers and that there is a risk that an over-familiarity with very high APRs makes them meaningless. However, under EU law we are restricted in what we can do on price information in adverts.
- 6.46** While there is merit in considering how prices are displayed, our proposals target the large costs consumers face when they do not pay on time. For these consumers, we are not convinced that the best way to protect them is by changing the way prices are displayed. High-cost short-term credit providers do appear to make it clear what it will cost the customer to borrow what they want over different periods of time. Bristol University found only 7% - 13% of consumers that they surveyed did not know about the cost of the loan.<sup>34</sup>
- 6.47** Research also suggests that consumers consider product features such as speed, flexibility and ease to be more important than cost.<sup>35</sup> This tells us that providing more information about, or making changes to, price information may not be the most effective way to better inform consumers of the risks, or prevent irresponsible lending and borrowing.
- 6.48** Finally, consumers may have no alternative to payday loans. Evidence from Policis and Toynbee Hall suggest 34% rely on these loans to manage their commitments where other sources of mainstream credit have been exhausted.<sup>36</sup>

<sup>33</sup> Department for Business, Industry and Skills, *Payday Lending Advertising Research*, produced by Ipsos Mori, 2013.

<sup>34</sup> Personal Finance Research Centre, University of Bristol *The impact on business and consumers of a cap on the total cost of credit 2013* Bristol Report, p31. The paper also references other work which found similar awareness of total cost even where consumers could not give the APR.

<sup>35</sup> Bristol Report, OFT, *Payday lending compliance review*, 2013, Karen Francis, Texas Law Review, Vol 88:611, p611-638, *Rollover, Rollover: A Behavioural Law and Economics Analysis of the Payday-Loan Industry*. An academic experiment in the United States also found efforts to make upfront pricing more transparent; including efforts to use Behavioural Economics, have no impact on consumer choices. Bertrand, M, Morse, A, *Information Disclosure, Cognitive Biases and Payday Borrowing*, MFI Working Paper Series No. 2009-007, October 2009.

<sup>36</sup> Policis and Toynbee Hall, *The consumer dynamics of problem debt: Draft of final report of the Policy Panel'*

### Where better disclosure could help

- 6.49** One of the problems identified in the market is customers rolling over their debt rather than repaying at the end of the agreed loan term – this builds up charges and increases the overall cost of their borrowing. The OFT review suggests that 28% of loans are rolled over or refinanced, because the borrower has not paid off their loan within their original agreed term.
- 6.50** This can lead to large costs to consumers already potentially in difficulty, which can have a big effect on their lives. The Bristol Report found that 41% to 46% of payday loan customers showed signs of financial stress in the last 12 months.<sup>37</sup> Research in America has also shown that, for some low-income households, the burden of borrowing inhibits their ability to pay important bills.<sup>38</sup>
- 6.51** Considering the significant impact on a consumer's financial well-being, we believe that consumers should be alerted to the very particular risks associated with rolling over their loans, so they can assess whether a high-cost short-term product is right for them.

### What we propose

- 6.52** Currently, adverts for payday loans are not required to provide a risk warning about taking out a loan. This is a significant concern for us considering the problems identified. Of those that do have to include pricing information, there is no warning about the particular risk associated with rollovers.
- 6.53** We propose that all financial promotions for high-cost short-term loans will need to carry a 'risk warning', irrespective of whether they trigger the CCD pricing disclosure.<sup>39</sup> By this we mean a warning alerting the consumer to the potential risks.
- 6.54** Academic work on high-cost short-term credit suggests that 'behavioural biases' may be why some consumers borrow more than they can afford.<sup>40</sup> For these warnings to be effective, consumers need to consider the likelihood of not paying back the debt and the financial impact from not doing so.<sup>41</sup> With that in mind, the department of Business, Innovation and Skills (BIS) carried out research, with consumers testing which warnings are likely to be most effective.<sup>42</sup> Our proposed risk warning is based on the findings from this research, and we have also worked with the Money Advice Service. This includes signposting debt advice, as many potential loan customers may already have concerns around money or be in debt when considering a high-cost short-term loan.

<sup>37</sup> Bristol Report, p67. The report uses indicators such as failure to pay household bills as an indicator of financial stress. Research in America has also shown that those consumers who end up rolling over their loan can end up paying a large part of their income in interest payments and this can cause real harm to their well-being and make paying for essential goods increasingly difficult, compared to those consumers who do not.

<sup>38</sup> Melzer, B., *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, Kellogg School of Management, Northwestern University: [www.kellogg.northwestern.edu/faculty/melzer/Papers/realcosts\\_melzer\\_07.02.09.pdf](http://www.kellogg.northwestern.edu/faculty/melzer/Papers/realcosts_melzer_07.02.09.pdf)

<sup>39</sup> There will be an Image ad exemption, where adverts simply provide brief factual information.

<sup>40</sup> Two 'behavioural biases' could be important obstacles to consumers understanding the real costs of this. These are 'over-optimism' – consumers do not believe they will fail to pay off their loan on time so do not consider the risks or costs of not doing so; and 'hyperbolic discounting' – where consumers fail to consider the future costs against the benefits now, and may come to regret that decision.

<sup>41</sup> Bertrand, M, Morse, A, *Information Disclosure, Cognitive Biases and Payday Borrowing*, MFI Working Paper Series No. 2009-007, October 2009, Karen Francis, *Texas Law Review, Rollover: Rollover: A Behavioural Law and Economics Analysis of the Payday Loan Industry*.

<sup>42</sup> Department of Business, Industry and Skills, *Payday Lending Advertising Research*, produced by Ipsos Mori, 2013.

- 6.55** We propose to require firms to include the following words in their financial promotions:

#### Updates to our Handbook

3.4.2 (R)(1) A financial promotion must contain the following risk warning:

'Think! Is this loan right for you?

Over 2 million short-term loans were not paid off on time in 2011/12<sup>43</sup>. This can lead to serious money problems.

If you're struggling, go to [www.moneyadvice.service.org.uk](http://www.moneyadvice.service.org.uk) for free and impartial help.'

(2) Each warning must be included in a financial promotion in a prominent way.

- 6.56** This risk warning is targeted at those consumers who are unaware of the risks and costs associated with not paying back a loan on time and those consumers that would benefit from impartial debt advice. The wider economic environment is likely to mean that there will be a continuing strong demand for these loans.
- 6.57** We propose in our rules that the risk warning is displayed in a prominent way. We welcome views on whether this is sufficiently clear or whether we should support this with guidance on how we would expect firms to comply when advertising through different channels.
- 6.58** We want to hear your views on how effective a risk warning is likely to be and whether we have made the text as effective as possible at changing behaviour. We would also be interested to hear if there is a case for considering risk warnings on other (or all) credit products.

#### Q14: Do you have any comments on our risk warning?

#### Information on free debt advice

- 6.59** Under the CCA, lenders are currently required to provide customers in arrears and in default with information, including on sources of free debt advice. However, many customers who could benefit from this information do not go into default because they roll over their loan instead, the effectiveness of this policy is limited. According to a Citizens Advice survey, only 8% of respondents were told about the availability of free debt advice.
- 6.60** We propose to introduce a new rule to require lenders to provide customers with this information before their loan is rolled over. As with the risk warning, this should help some consumers make more informed decisions, in this instance about managing their debt.

<sup>43</sup> According to the OFT compliance review, the total number of loans in 2011/12 was between 7.4 and 8.2 million and 32% of all loans were repaid late or not at all. This means that between 2.4 and 2.6 million loans were not repaid on time. OFT, *Payday Lending Compliance Review Final Report*, Annex A, paras A.5 and A.32-34.

### Updates to our Handbook

6.7.20 Before a firm agrees to refinance high-cost short-term credit, it must send an information sheet in substantially the same form as that required where section 86B of the CCA applies, but with the following modifications:

(1) in place of the title and first sentence of the information sheet include:

“High-cost short-term loans

Missing your payment deadline

Not paying back your loan on time will significantly add to the cost and may continue to grow, here is some important information to help you.”; and

(2) omit the bullet point concerning time orders.

### Q15: Do you have any comments on our proposals to require high-cost short-term lenders to provide information on free debt advice before the point of rollover?

#### Impact of our proposals

**6.61** In deciding to take forward these proposals we have looked carefully at the balance of benefits for consumers against the impact on firms. We believe that our proposals will substantially benefit consumers overall. Our consideration has been informed by the OFT compliance review, Europe Economics’ research on the impact of our proposals (which has been informed by Bristol University’s consumer research and research by Toynbee Hall and Policis) and from what we know as a financial services regulator about consumer outcomes of unaffordable lending. We have also examined the experience in other jurisdictions.

#### Benefits to consumers

**6.62** Overall, consumers will benefit from our proposals. Europe Economics estimate the benefit to consumers from improved compliance in consumer credit, including in payday lending. This measures a reduction in the detriment to consumers from firms improving how they engage with consumers, reducing detriment that is reflected in the complaints consumers make.

**6.63** Table 6.2, reproduced from Table 7.5 in Europe Economics’ report, presents their estimates, based on the National Audit Office’s (NAO) estimate of detriment in consumer credit,<sup>44</sup> and shows that they expect a material reduction in this of between 27% and 55%.

<sup>44</sup> NAO (2012), ‘Office of Fair Trading: Regulating Consumer Credit, Technical Paper’, [www.nao.org.uk/wp-content/uploads/2012/12/1213685\\_tech\\_paper.pdf](http://www.nao.org.uk/wp-content/uploads/2012/12/1213685_tech_paper.pdf)

**Table 6.2 – Summary of reduction in detriment (Table 7.5 from EE report)**

	Reduction in Detriment			Benefit (£m)		
	Low		High	Low	Central	High
<b>Banks and building societies</b>	16%	to	32%	16.9	35.7	61.4
<b>Card monolines</b>	16%	to	32%	1.3	2.8	4.8
<b>Payday</b>	27%	to	55%	1.1	2.3	4.0
<b>Mainstream and bricks and mortar</b>	19%	to	37%	0.4	0.8	1.3
<b>Home credit</b>	19%	to	37%	0.8	1.6	2.8
<b>Non-bank lenders and consumer hire</b>	18%	to	36%	6.1	12.9	22.1
<b>Credit unions</b>	16%	to	32%	0.1	0.1	0.2
<b>Secondary non-motor retail</b>	18%	to	36%	-	-	-
<b>Secondary motor</b>	18%	to	36%	-	-	-
<b>Traditional credit brokers</b>	16%	to	33%	0.7	1.5	2.6
<b>Aggregators and lead generators</b>	13%	to	26%	-	-	-
<b>Credit reference agencies</b>	13%	to	26%	0.1	0.1	0.2
<b>Debt managers and related</b>	21%	to	41%	1.8	3.9	6.7
<b>Debt collectors and related</b>	14%	to	28%	3.3	6.9	11.9
<b>Total</b>				32.4	68.6	118.0

**6.64** However, these benefits only capture part of the overall benefit to high-cost short-term credit consumers. In particular, the substantive benefits we expect from reducing irresponsible lending to be largely excluded from the above NAO-based estimates for two reasons. The estimates above are based on reductions in detriment related to consumer complaints. Because consumers often do not attribute problems with an irresponsible loan to the lender and complain, and because the group of consumers most likely to suffer from unaffordable borrowing are also least likely to complain, this may mean the benefits are under-estimated.<sup>45</sup>

**6.65** These broader benefits are qualitatively analysed by Europe Economics and Table 6.3 presents their judgement on the extent of benefits to high-cost short-term credit consumers from our high-cost short-term credit proposals and other proposals we are introducing. It shows that Europe Economics expect our proposals to be strongly effective in reducing unaffordable lending, reducing poor sales of products and services, and to a lesser extent reducing detriment arising from unsuitable advice.

<sup>45</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm*, section 7.4.1

**Table 6.3 Summary of qualitative benefits — payday lending (Table 7.4 in EE report)**

	Unaffordable lending	Poor sales of products and services	Unsuitable advice	Loss of client money and assets
Authorisation and annual fees	✓✓	✓✓	✓✓	✓
Appointed representatives				
Approved persons	✓	✓		✓
High-level standards, reinforced by increased enforcement	✓✓	✓✓	✓	
Supervision and regulatory reporting	✓✓	✓✓		
Complaints and redress	✓	✓	✓	
Financial promotions	✓	✓		
Health warnings	✓			
Affordability assessments	✓✓			
Limit rollovers	✓✓	✓✓	✓✓	
Limit CPA usage	✓✓	✓✓	✓	

Policy effectiveness: (Strong = P✓✓, Good = ✓ or otherwise Negligible)

#### 6.66 Consumers will benefit in a range of ways from our proposals. Specifically, consumers will:

- Benefit from borrowing more affordably:** Borrowers will borrow less or not at all, typically leading them to a better outcome. In line with Europe Economics' analysis of improved outcomes,<sup>46</sup> this includes consumers benefiting by switching to more suitable credit alternatives, turning to less detrimental grey lending, e.g. support from friends and family, doing without or doing with less credit, all of which can mitigate major detriment from escalating financial difficulty (e.g. debt spirals). Given the very severe detriment experienced by these borrowers, we would expect that they should generally strongly benefit. We also believe that many of the borrowers that Europe Economics identified as facing restricted access to credit will fall into this category given our view that it is likely that borrowers rolling over more than twice are experiencing financial difficulty.<sup>47</sup>

<sup>46</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, section 8.5.3.

<sup>47</sup> Personal Finance Research Centre, *University of Bristol The impact on business and consumers of a cap on the total cost of credit 2013*, p.iv.

- **Benefit from better treatment when encountering payment difficulties:** Our proposals should lead consumers to face less pressure to roll over and to be offered more suitable alternatives when experiencing difficulty making a payment. Also, consumers should benefit from less psychological distress and greater control from the much more measured use of CPA by lenders, reducing the severe harm associated with very heavy use of CPA.<sup>48</sup> Indebted consumers, who would previously have been offered additional rollovers, should experience better outcomes where they instead enter into sustainable solutions (e.g. forbearance or a repayment plan with the lender). Consumers who benefit in these ways are likely to experience a very significant benefit from our proposals. It is difficult to estimate how large a group this will be once our proposals are in place, since to the extent that lending is more responsible, borrowers should experience fewer payment difficulties.
- **Benefits from borrowers choosing loans that better meet their needs/preferences:** Behavioural economics evidence suggests widespread behavioural biases among payday consumers.<sup>49</sup> So some borrowers may benefit who are borrowing affordably, by not choosing a loan or rolling over in a way that reflects the best value for them. Our proposals may help them to choose a loan, or to switch at the point of rollover, in ways that better meet their true preference. Given the evidence of behavioural biases, the group of consumers that stand to benefit from choosing better loans could be large; however, the extent of this benefit is difficult to judge.

**6.67** In reaching our conclusion that the proposed measures will substantially increase consumer protection overall, we have taken into account ways in which some consumers may suffer from unintended consequences:

- **Detriment from consumers not being able to roll over their loan more than twice where it is affordable for them to do so:** These consumers would want to roll over their loan a third time and who, on a reasonable affordability assessment at the time of the third rollover, would be expected to repay on time. These consumers will be directly affected by our proposals to cap rollovers to two. These consumers could face detriment by not being able to manage their finances as easily, for example, where they may have to do without and this prevents them from meeting an important financial commitment (e.g. rent, essentials, bills). We believe this group is very small because the likelihood that a borrower is simply facing a temporary change in circumstances where a further rollover is extremely rare. The more likely explanation when a borrower has to extend a loan for more than one period, and certainly more than two, is that the individual is in financial difficulty, given the evidence that the finances of customers who take out high-cost short-term loans are often finely balanced (the Bristol Report found that 41% to 46% of high-cost short-term credit customers showed signs of financial stress in the last 12 months<sup>50</sup>).

<sup>48</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, section 8.3. This benefit, given consumer are more likely to complain when they experience such problems, is partly covered by the NAO-related estimate of benefits above.

<sup>49</sup> *Rollover, Rollover: A Behavioural Law and Economics Analysis of the Payday Loan Industry*, Karen E. Francis Texas Law Review [Vol. 88:611].

<sup>50</sup> Personal Finance Research Centre, University of Bristol *The impact on business and consumers of a cap on the total cost of credit* 2013 Bristol Report, pg iii

- **Detriment where consumers are prevented from borrowing who, on a reasonable assessment of affordability, cannot afford to repay the loan but who then face worse outcomes as a result:** Credit will be restricted to these consumers as a result of lenders carrying out more robust affordability checks, incentivised by our rules on rollovers and CPAs. These consumers could suffer detriment, for example, from illegal lending or doing without which brings on detriment sooner than might otherwise have occurred. These consumers are likely to be in a very difficult situation and face very limited access to credit generally. Unfortunately, these consumers are also those most likely not to be in a position to afford any available credit, and as a result, credit is not a sustainable solution to the underlying drivers of their financial problems (e.g. it simply or probably postpones a difficult situation and increases debt in the process). Research conducted by the University of Bristol's Personal Finance Research Centre found that consumers who used this type of credit to avoid financial difficulties are more likely to make matters worse than to resolve them.<sup>51</sup> Also, there is evidence this group may be small, for example, the same research found that illegal lending was not an option for the overwhelming majority of consumers.<sup>52</sup>

These are the direct effects of our proposals; however firms may change their business models and lending strategies in a way that may have indirect consequences on consumers that are detrimental.

- **Detriment from consumers not being able to borrow as much as they would prefer to do or not borrow high-cost short-term credit at all where it is affordable:** Europe Economics predicts that lenders could change their lending strategy in a way that restricts credit to consumers where the loan is affordable, for example, where they have poor credit scores. These consumers could face detriment by not being able to manage their finances as easily, for example, where they may have to do without and this prevents them from meeting an important financial commitment (e.g. rents, essentials, bills). The extent of detriment could potentially be more severe, for consumers who would have obtained short-term benefits from the additional credit they could have obtained in the absence of our rules, but must forego these under our proposals. As this group of consumers was in a position initially to afford to borrow high-cost short-term credit, we expect that many will have access to alternative resources. As such, we expect this group to be small.
- **Detriment from consumers paying more for lending than they did before:** Europe Economics estimate that our proposals will lead to market exit, reduction in lending and lenders taking measures to recover lost revenue from remaining customers. Given consumers' price insensitivity in this market, we agree that this is a real possibility. Europe Economics estimate that £10-£12m will be passed through to remaining customers by lenders. This translates into about £1.60 to £2.20 in increased cost per new loan. This increase is significant as a proportion of costs. However, given the increase is small in absolute terms, the detriment from this should not be very material overall.<sup>53</sup>

<sup>51</sup> Personal Finance Research Centre, *University of Bristol The impact on business and consumers of a cap on the total cost of credit 2013*, pg iii

<sup>52</sup> This research found that a very small number of payday consumers said they would consider using an illegal money lender. This ranged from one per cent of online payday loan customers, to two per cent of retail payday loan, name of report, Personal Finance Research Centre, *University of Bristol The impact on business and consumers of a cap on the total cost of credit 2013*, pg 64.

<sup>53</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 167

- 6.68** Europe Economics expect the increases to barriers to entry and barriers to innovation in this market from our proposals to be low<sup>54</sup> and note that there are firms currently considering entry to the market. In our judgement these indirect consequences could be mitigated in the medium to long-term as existing firms and new market entrants find more efficient ways of lending affordably. This could be in the form of credit unions providing high-cost short-term lending at lower prices or new market entrants targeting consumers who could afford loans, but whose access has been restricted.
- 6.69** Overall, in our view, the consumer benefit substantially exceeds any consumer harm. Also, given that many of the borrowers that benefit will do so to a greater extent than those who experience harm will suffer, we strongly believe that our proposals should benefit consumers overall, which advances our consumer protection objective.
- 6.70** This conclusion also reflects our strong view that regulating lenders so that they target borrowers who can afford to repay the loan is the only possible sustainable outcome for the sector and consumers.

### **Why we believe that our proposals are the best way to protect consumers.**

#### **Alternative options**

- 6.71 Price cap on the total cost of credit** – The benefits of a total cost of credit cap has been looked at by the Personal Finance Research Centre at the University of Bristol. This report highlighted that 17 EU member states have some form of price restriction. Their research was ambiguous, on the one hand suggesting possible improved lending criteria and risk assessments. On the other, prices may drift towards a cap, which could lead to prices increasing or lead to a significant reduction in lenders exercising forbearance.<sup>55</sup> Neither of these outcomes latter would be beneficial for consumers. Clearly this is a very intrusive proposition and to ensure we fully understand the implications we have committed to undertake further research once we begin regulating credit firms and therefore have access to regulatory data.
- 6.72 Cap on loan amount** – Some American states have taken further steps to address inadequate affordability assessments by setting caps on the maximum loan amount, either as a total (e.g. \$500) or as a proportion of income (e.g. 25% of income). However, the level of limits chosen in these states has been criticised by the US consumer group the Centre for Responsible Lending.<sup>56</sup> This is because limits do not take into consideration the borrower's other obligations and expenses.
- 6.73 Consumer education measures** – Risk warnings for consumers on advertisements and the provision of information on free debt advice are being proposed to alert consumers to the risks of rollovers. We hope that this will empower consumers at key decision points with information that could lead to them taking decisions that lead to better outcomes. However, the CBA suggests that these proposals may have a limited effect for consumers who disregard these warnings, particularly those that have no alternative but to take out the loan.<sup>57</sup>

<sup>54</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg101-104 and pg106-107

<sup>55</sup> Personal Finance Research Centre, University of Bristol *The impact on business and consumers of a cap on the total cost of credit* 2013, pg v-vi.

<sup>56</sup> Uriah King and Leslie Parrish,, Centre for Responsible Lending, *Springing the Debt Trap: Rate caps are only proven payday lending reform*, 13 December 2007.

<sup>57</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg 156.

- 6.74 Greater transparency of pricing** – The evidence suggests that consumers find APR confusing,<sup>58</sup> yet are aware of the cost of credit through other means.<sup>59</sup> They are also more interested in speed and convenience and may be over-confident about their ability to pay back on time. So we believe there are limitations to clearer pricing leading to a reduction in unaffordable lending.
- 6.75 Strengthened supervision and enforcement of existing affordability requirements** – We are strengthening the supervision and enforcement of existing affordability requirements and the high-cost short-term credit package must be seen in light of the wider reforms. Our rules are intended to provide the right incentives to check affordability. Having clear rules also allows for more cost-effective supervision and enforcement.
- 6.76 Stronger protections around CPAs** – Other options include strengthening consumer information around CPA use. The OFT consulted in December 2011 on a limit of just one CPA, but decided to strengthen provisions around transparency and forbearance instead, in revised debt collection guidance published last November. We now know from consumer groups that these protections have not led to the consumer benefits that the OFT had intended, and this is backed up by data that we have seen from a bank and Visa on current practices of high-cost short-term credit lenders. We know that firms continue to make multiple requests on a daily basis and at variable amounts, scraping accounts with little evidence of any regard to a consumer's well-being.
- 6.77** CPAs minimise markedly firms' collection costs and current practice means we simply do not believe better information will be effective. In our view a firm should recognise a CPA simply is not an appropriate vehicle for debt collection if it tries and fails to collect via a CPA twice. We think stronger interventions are needed to respond to the consumer detriment. However, we have proposed to limit the number of CPA attempts to two, rather than the limit of one, which the industry has previously argued was unduly restrictive and risked adverse unintended consequences for borrowers.

**Q16: Do you have any comments on the effectiveness of price capping?**

### Competition

- 6.78** There is plenty of evidence available on the scale and impact of detriment for consumers. There is also evidence that the problems in this market are escalating rapidly. The high-cost short-term credit sector has grown from an estimated £900 million in 2008/09 to an estimated £2.0 to £2.2 billion in 2011/12<sup>60</sup>, and there is significant evidence from consumer groups of poor industry practices that are leading to large scale problems for consumers. For example, between January and June 2013, StepChange helped 30,762 people with high-cost short-term loan debts, compared to 36,413<sup>61</sup> for the whole of 2012. We believe we need to act now to advance our consumer protection objective. This is in line with calls from consumer groups, including StepChange, Citizens Advice, Which? and the Centre for Responsible Credit that urgent action is needed.

<sup>58</sup> Department for Business, Industry and Skills, Payday Lending Advertising Research, produced by Ipsos Mori, 2013

<sup>59</sup> Personal Finance Research Centre, University of Bristol *The impact on business and consumers of a cap on the total cost of credit* 2013, p31

<sup>60</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, pg147

<sup>61</sup> <http://www.stepchange.org/Mediacentre/Pressreleases/Paydayloansfurtheractionneeded.aspx>

- 6.79** Europe Economics have estimated that our measures will have a significant economic impact on payday lenders, so we have considered carefully alternative measures that could have less of an impact on them.
- 6.80** However, we are also conscious that the impact on high-cost short-term lenders who are lending responsibly should be proportionate. Our measures will have an impact on those lenders who are not doing proper affordability assessments and base their business models on the expectation that they can recoup money from those who can least afford it, through abusive uses of rollovers and CPAs. Our proposals should not materially affect high-cost short-term lenders who are lending responsibly.
- 6.81** We have also considered carefully if there is a more pro-competitive way to meet our consumer protection objective.
- 6.82** There is clear evidence of problems with competition in the high-cost short-term credit market. The OFT, in their referral of the payday credit lending to the CC,<sup>62</sup> identified some key problems:
- varying compliance by lenders suggesting that lenders investing more in compliance may be putting themselves at a competitive disadvantage relative to lenders that do not
  - practices by lenders that hamper consumers' ability to identify/compare the full cost of payday loans when buying a loan and the significant proportion of borrowers that have poor credit histories, limited access to other forms of credit and/or pressing needs, both weakening price competition between lenders
  - barriers to switching to alternative lenders, products or options at the point of rollover (which the OFT suspects benefits incumbent lenders)
  - high concentration, barriers to entry and to expansion exacerbating the competition problems arising from the other features
- 6.83** These competition problems in the high-cost short-term credit market present a significant challenge to designing pro-competitive policies to materially improve consumer outcomes, particularly to lower unaffordable borrowing in the market. The most significant challenge is the need to empower consumers to accurately judge, when considering a high-cost short-term loan, whether they can expect to repay the loan, so that they can effectively pressure lenders only to offer affordable loans.
- 6.84** We considered some measures that would work in this way. For example, measures that would increase the transparency of loan features at the point of sale (e.g. on price or the use of CPAs) and other consumer education measures. We rejected transparency measures in light of evidence that consumers focus on speed and convenience, which suggests these would not be very effective. On consumer education, we are proposing a risk warning to emphasise to consumers the dangers of unaffordable borrowing. We accept that this may not have as significant impacts as we may like, given consumers' focus on speed and evidence of behavioural biases, such as overconfidence.<sup>63</sup> Because of this, we concluded that a risk warning alone would not be sufficient to advance our consumer protection objective.

<sup>62</sup> [http://www.offt.gov.uk/shared\\_offt/markets-work/payday-MIR.pdf](http://www.offt.gov.uk/shared_offt/markets-work/payday-MIR.pdf)

<sup>63</sup> There is growing evidence of consumer's being subject to behavioural biases in the payday lending market. See, for example, Campbell, Jackson, Madrian and Tufano (2010) 'The Regulation of Consumer Financial Products: An Introductory Essay with Four Case Studies', *Harvard Kennedy School Working paper*, for a discussion of payday lending in the US.

- 6.85** The option of carrying out further behavioural research to design intervention that might effectively ‘nudge’ consumers to more affordable loans is one we considered and are keeping open for the future. However, given the current limitation in our ability to compel firms to provide us with data, this was not a practicable option at the time of developing proposals.<sup>64</sup>
- 6.86** Given the obstacles to strengthening competition on the consumer side, the next most pro-competitive option would be interventions to improve lending by firms, while limiting adverse impacts on their ability to compete. Here we considered more actively supervising and enforcing current affordability requirements without introducing further rules. However, given the limits to our ability to monitor firms and the evidence of significant non-compliance with existing rules in the recent OFT compliance review, we concluded that this (even with the risk warning) would not sufficiently improve consumer outcomes.
- 6.87** We concluded that rules that targeted the unaffordable lending resulting from ineffective competition in the market would be necessary to secure adequate consumer protection. The additional rules we are proposing, the caps on rollovers and the use of CPA, aim to primarily prevent borrowers who are borrowing unaffordably from being lent to irresponsibly by firms.
- 6.88** As explained above, we strongly believe that the addition of a limit on rollovers and CPAs, should prevent lenders from targeting borrowers who are most likely to be in financial difficulty and broadly benefit consumers overall.
- 6.89** We also considered the possible detrimental impacts of these rules on competition. Europe Economics found that our high-cost short-term credit proposals and the broader policy package, should not lead to significant increases in barriers to entry or hamper innovation in the high-cost short-term lending market. However, in their analysis of impacts they estimate a significant reduction in firm revenues and market exit following the introduction of the rules, with a subsequent re-adjustment as firms change their lending strategies.
- 6.90** Europe Economics also expect the exit to be mainly by firms who are primarily targeting borrowers who will no longer be profitable following the rollover and CPA cap. Given this, we expect that the most affected firms should be those that have been disproportionately targeting borrowers who are not in a position to afford to repay the loans. For these reasons, although the market exit is undesirable in principle, in practice we expect it to weaken competitive pressure on lenders to target borrowers who they should not have been targeting.
- 6.91** As Europe Economics discuss, with time we would expect firms to adjust their lending strategies to target more appropriate consumers so the significant initial impacts are expected to moderate with time. Also, although there are significant existing barriers to entry and expansion in the high-cost short-term credit market, Europe Economics point out, from their evidence gathering, that there are firms considering entering the market. These firms should have a competitive advantage in being able to enter with knowledge of the new regime rather than having to adjust existing lending strategies, which should also increase competitive pressure on other firms to lend responsibly. Finally, there is also US evidence of intrusive regulatory interventions, where lending initially fell but subsequently recovered, for example in Kentucky.<sup>65</sup>

<sup>64</sup> The FCA will obtain this power on 1st April 2014, when it takes over regulation of consumer credit from the OFT.

<sup>65</sup> Experience in the USA provides some evidence for this. In Kentucky, since 2010, a one-time fee is charged for taking out a payday loan, and “rolling over” loans in Kentucky is illegal. Kentucky law also restricts people from taking out more than two payday loans at any one time totalling no more than \$500. The regulations initially impacted negatively on the volume of loans. However, they returned to their original levels within a year. However, this rollover policy was in isolation of any further restriction on revenue collection. See Veritec (2011) “Report on Kentucky Payday Lending Activity for April 30, 2010 through April 30, 2011”

- 6.92** For these reasons, we expect: (i) significant exit to be a symptom of a necessary adjustment to reduce irresponsible lending; (ii) a decrease in competitive pressure on firms to be non-compliant by lending irresponsibly; and (iii) that lending volumes should recover as remaining firms and new firms target more appropriate borrowers.
- 6.93** Finally, the CC has begun its investigation into payday lending to come to its view on the state of competition and possible remedies. We see our intervention as potentially complementary to the CC's work. Improvements to competition by the CC should further improve outcomes for consumers in the high-cost short-term credit market.

### **Proportionate and fair balance between protecting consumers and restrictions on high-cost short-term credit**

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- 6.94** Taking into account all of the arguments above, we believe that the proposals represent a fair and proportionate balance between the strong public interest in protecting consumers, particularly vulnerable consumers, against the economic effects of the additional burdens and restrictions on payday lenders. In the absence of these proposals, we would not observe the competition in this market working in the interests of consumers, either to restrict rates or discourage unsustainable lending.
- 6.95** Our proposals will have a significant impact on the economic interests of high-cost short-term lenders. Europe Economics has estimated that the transfer and our proposals could lead to between 25% and 30% of high-cost short-term lenders leaving the market, which is a reduction in high-cost short-term credit revenue of up to £200m, and an initial reduction in high-cost short-term lending of between £625m and £750m from firms no longer lending to consumers who were only profitable to them through rollovers and CPAs.
- 6.96** However, the purpose of these interventions is redressing the balance between lenders and consumers. The weight of evidence, for example from consumer groups, the OFT compliance review and the evidence given to the Public Accounts Committee,<sup>66</sup> suggests this to be the case. Furthermore, we believe there are no alternative proposals that would have a lesser impact on the economic interests of payday lenders while still achieving our objective of securing an appropriate degree of protection for consumers. So we believe our proposals to be fair and proportionate.
- 6.97** We believe our proposals are most likely to affect firms whose business model is directed at consumers who are unlikely to be able to borrow affordably. We believe those firms that carry out proper affordability assessments, as provided for at present under the OFT's Irresponsible Lending Guidance, should be substantially less affected by the rollover and CPA restrictions.
- 6.98** Given the backdrop of significant harm being experienced by a large number of high-cost short-term borrowers, and the very substantial benefits to consumers we have identified from our proposed interventions, we believe that our proposals strike a fair balance between consumer protection and need for us to be proportionate when we impose significant costs on firms.

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<sup>66</sup> [www.publications.parliament.uk/pa/cm201314/cmselect/cmpublic/165/165.pdf](http://www.publications.parliament.uk/pa/cm201314/cmselect/cmpublic/165/165.pdf)

### Next steps

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- 6.99** We have set out the proposed new rules and guidance that we aim to introduce to improve outcomes for consumers in the high-cost short-term credit market.
- 6.100** From April 2014, we will have the power to gather information from consumer credit firms and we will work closely with the other competition authorities to develop comprehensive evidence so we can consider whether structural changes, like price capping or setting maximum loan amounts, are necessary to ensure a competitive market that delivers better outcomes for consumers.
- 6.101** We remain concerned at the treatment of customers in financial difficulty, particularly in relation to fees and charges. We will consider carrying out a thematic review of market practice in this area once firms have transferred to the FCA.
- 6.102** Lenders only have access to the data that has been made available to the particular credit reference agency (CRA) that they have sought information from. The rules on how data is shared in the UK credit market by CRAs are set by the Steering Committee on Reciprocity (SCOR), which includes representatives from trade associations and lenders. We would like SCOR to identify and remove any blockages faced by high-cost short-term lenders and CRAs in sharing real-time data with the rest of the credit market as a matter of urgency. This is an area of interest to us.
- 6.103** We will also monitor the sector closely to ensure firms do not adjust their business models to circumvent the consumer protection policies we introduce. Where we see evidence of this (such as above-average rates of non-repayment on time or an increase in the term of firms' loan book), this may call into question the suitability of a firm and whether it meets the conditions for full authorisation.

## 7.

# Prudential standards for debt management firms and some not-for-profit advice bodies

In the March CP we consulted on having prudential standards for debt management firms. This has now been widened to include some not-for-profit debt advice bodies.

This chapter covers:

- all commercial debt management firms
- not-for-profit debt advice bodies that, at any point in the last 12 months, have held £1m or more in client money, or as the case may be, are expected to hold have £1m or more in client money in the next 12 months.

We are proposing that the prudential requirement for these firms will be the higher of:

- £5,000
- 0.25% of relevant debts under management

We are proposing to transition our prudential rules so that they will not all become fully operational until 1 April 2017.

### Why do we need prudential standards?

- 7.1** Prudential standards aim to minimise the risk of harm to consumers by ensuring that firms responsibly manage their business risks. Through these standards we can make sure that firms have enough financial resources available at any time to cover potential operational and compliance failures and/or pay redress.
- 7.2** In March we proposed to apply prudential standards to commercial debt management firms, subject to further analysis work.

- 7.3** Since March, we have liaised with debt management trade bodies to ask firms a number of questions about their business.<sup>1</sup> Using the data we received in response, we have designed an appropriate regime that is not overly complex and that balances the requirement to protect consumers with the need to ensure there is enough competition in the market by removing unnecessary barriers to entry.
- 7.4** Following feedback from FSA CP13/7, we decided to widen the scope of our requirements to include some not-for-profit debt advice bodies. We believe that is in line with our prudential philosophy to focus on entities that pose greater risks to consumers.

### Prudential requirements

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- 7.5** We propose that our prudential requirement<sup>2</sup> will apply to:
- debt management firms
  - not-for-profit debt advice bodies that, at any point in the last 12 months, has held £1million or more in client money, or as the case may be, expect to hold £1million or more in client money over the next 12 months
- 7.6** We propose that the prudential requirement for these firms will be the higher of:
- a fixed minimum amount, or
  - a percentage of a volume-based measure
- The fixed minimum amount that firms will need to hold**
- 7.7** The fixed minimum amount that firms will be required to hold will be £5,000.
- 7.8** We believe this is an appropriate minimum amount given the need to balance our objective of protecting consumers and creating a proportional regime that does not constrain competition.
- The volume-based measure that we will use**
- 7.9** The volume-based measure that we will use will be 0.25% of the total value of 'relevant debts under management' outstanding.
- 7.10** Relevant debts under management will be the debts in relation to the activity of debt adjusting. This will not include debt adjusting where the firm is exempt.<sup>3</sup>
- 7.11** Firms will calculate the volume-based measure annually on a firm's 'accounting reference date' (meaning its financial year end), and it will cover the total relevant outstanding amount that a debt management firm's clients owe to their creditors.

<sup>1</sup> We would like to thank the trade bodies (DRF and DEMSA) for helping us in this process and firms for completing the questionnaire.

<sup>2</sup> Our draft Handbook rules can be found in Appendix 2 of this paper.

<sup>3</sup> A firm may be exempt as a result of the exemption in the Exemption Order for insolvency practitioners, if it does not have a permission in relation to another regulated activity. A debt in relation to which a person is carrying on debt adjusting and is acting as an insolvency practitioner (within section 388 of the Insolvency Act 1986) is excluded from the calculation of its relevant debts under management (but a debt in relation to which the same person is carrying on debt adjusting that falls outside that exemption is included in the calculation).

### An example of what we mean by 'relevant debts under management' outstanding

This example is based on a single individual contract

- Total value of debt the client owes creditors = £100
- Total value of debt that the client must repay, which the debt management firm has negotiated with the client's creditors = £80
- Total amount of debt that the client has been able to pay = £10
- Current value of 'relevant debts under management outstanding' = £70 (£80 - £10)
- Volume-based prudential requirement =  $0.0025 \times £70$

**7.12** We believe that the volume-based measure total value of 'relevant debts under management' outstanding is the most appropriate way to align a firm's prudential requirement with the risk of harm it poses to consumers because it captures:

- the likelihood of firms holding large amounts of client money at any point in time
- the length of time it will take to wind down a firm
- the complexity of the firm including its size and number of customers

**7.13** Responses to FSA CP13/7 indicated that firms would not have difficulty in calculating this volume-based measure.

**7.14** To investigate whether we have calibrated our prudential policy proposal appropriately, we analysed whether our volume-based measure is a useful proxy for the cost of winding down a firm. We found that, on average, it would equate to a firm holding a prudential requirement equivalent to 14 weeks of fixed operating costs. This is similar to our prudential requirement for other firms.<sup>4</sup>

**7.15** We also propose to require firms to recalculate their prudential requirement if the value of their 'relevant debts under management' outstanding increases significantly (by more than 15%)<sup>5</sup> and to notify the FCA of any change in that requirement, so we can ensure that a firm's prudential requirements are always up-to-date and accurate.

**7.16** If a firm fails to comply with our rules we will consider taking enforcement action.

**7.17** Also, if a consumer credit firm is already prudentially regulated – so it is already subject to a prudential requirement – it will only be subject to the higher of the requirements, not both.

<sup>4</sup> Depending on the prudential regime in question, we typically require 13 weeks of fixed operating costs for firms that hold client money.

<sup>5</sup> For example, as a result of a takeover or the purchase of a book of clients.

**Q17: Do you agree with our proposals on how to calculate our prudential requirement for debt management firms and some not-for-profit debt advice bodies? If not, what amendments would you suggest, and why?**

### Prudential resources

- 7.18** A firm's 'prudential resources' are different from its 'prudential requirement'. While its prudential requirement is the minimum amount of capital it is required to hold, its prudential resource is the amount of capital it actually holds.
- 7.19** For a firm to comply with our rules, the amount of prudential resources it holds in total has to be more than its prudential requirement at all times.

**Table 7.1 – How firms will calculate their prudential resources**

<b>Prudential resources calculation</b>	Share capital + reserves + interim net profits <sup>7</sup> + eligible subordinated debt – investments in own shares – intangible assets – investments in subsidiaries – interim net losses.
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- 7.20** The components listed in Table 7.1 that constitute a firm's prudential resources are similar to existing prudential regimes for other firms which exhibit similar risks.

### Transitional arrangements for our prudential regime

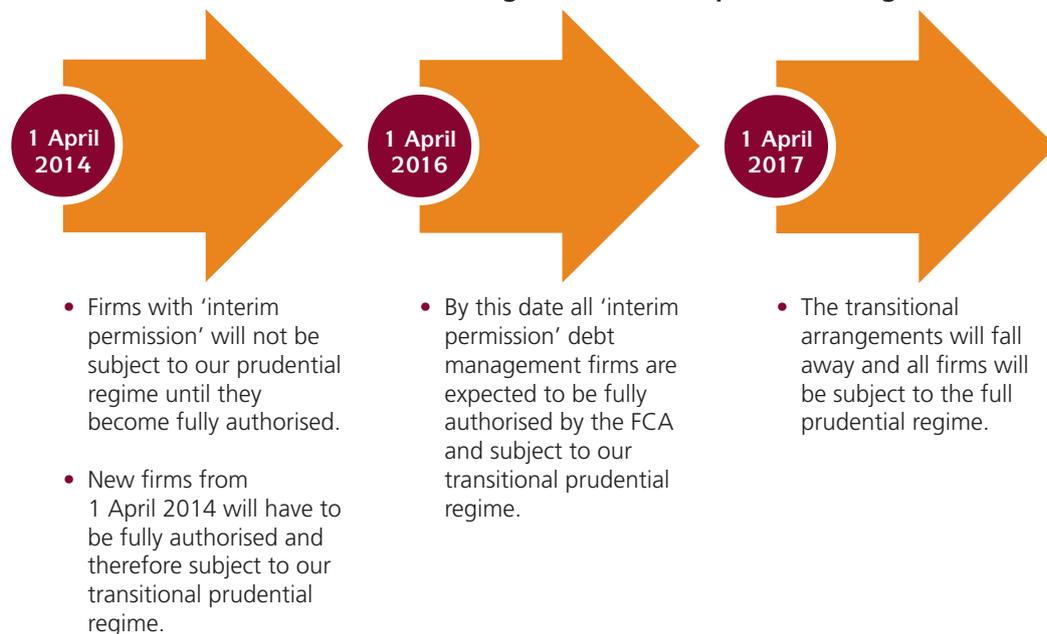
- 7.21** Firms with 'interim permissions' will not be subject to our prudential standards – they will only apply once the firm has become fully authorised.
- 7.22** Firms that do not have a consumer credit licence for debt management activities before 1 April 2014 will not be able to get an 'interim permission'. Therefore, they will have to become fully authorised and will then be immediately subject to our prudential standards.
- 7.23** We are conscious that, initially, firms may be unable to meet our prudential requirements. Therefore, to minimise the number of firms that may exit the market, we propose to allow a period of transition for all firms that affects how they calculate their prudential resources.
- 7.24** Up until 1 April 2017, all firms that are subject to our prudential requirements will not need to deduct 'investments in subsidiaries' and 'intangible assets' when calculating their prudential resources. This should give firms enough time to prepare for and meet our full prudential standards regime from 1 April 2017.

**Table 7.2 – How firms will calculate their prudential resources under our transitional arrangements**

<b>Prudential resources calculation up to 31 March 2017</b>	Share capital + reserves + interim net profits <sup>8</sup> + eligible subordinated debt – investments in its own shares – interim net losses.
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<sup>6</sup> As verified by the firm's external auditor, and net of tax, anticipated dividends or proprietors' drawings and other appropriations.

<sup>7</sup> Have to be verified by the firm's external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.

**Table 7.3 – Timeline of transitional arrangements for our prudential regime**

**Q18: Do you agree with our proposal to apply a transitional approach to prudential standards for debt management firms and some not-for-profit debt advice bodies?**

## 8.

# Conduct standards for some specific consumer credit activities

**In March we set out proposals for the following specific consumer credit activities:**

- providing consumers with debt advice
- peer-to-peer lending
- the outsourced tracing of debtors to third-party tracing agents

In this chapter we set out our updated proposals for these activities.

### Providing consumers with debt advice

- 8.1** In FSA CP13/7 we proposed to apply different rules and requirements to different types of debt advice. This would reflect the different nature of the advice given by firms and the associated risk to consumers.
- 8.2** We also proposed that if not-for-profit debt advice bodies (such as Citizens Advice Bureaux) and profit-seeking firms (such as debt management firms) are providing similar types of debt advice – for example, both advising consumers to enter into debt management plans – they should be subject to the same conduct rules.
- 8.3** We are now proposing<sup>1</sup> that:
- there should be two different types of debt advice provision:
    - generic advice that is not regulated debt counselling
    - regulated advice on the liquidation of a debt due under a consumer credit agreement (or a consumer hire agreement)

<sup>1</sup> The rationale behind our proposed approach is set out and discussed in our consideration of responses to question 17 of FSA CP13/7 in Annex 1.

- all regulated debt advice provision will be subject to conduct rules based on standards currently set out in the OFT's Debt Management Guidance<sup>2</sup>
  - where a firm gives generic debt advice in connection with (and ancillary to) carrying on a regulated activity, the firm will be subject to our Principles for Businesses<sup>3</sup>
- 8.4** We have produced draft guidance on the different types of debt advice (including examples) in chapter 17 of our Perimeter Guidance, known as PERG, in Appendix 2.

**Q19: Do you have any comments on our draft guidance on the debt counselling activity and our draft rules covering the provision of debt advice?**

### Peer-to-peer lending platforms

- 8.5** The Government has decided to make 'operating an electronic system in relation to lending' a new regulated activity. We agree that individuals<sup>4</sup> and relevant persons<sup>5</sup> that lend or borrow through a peer-to-peer platform should be appropriately protected.
- 8.6** We will be publishing a separate consultation paper on our proposed approach to regulating 'crowd-funding' including the **lending/investment** aspects of peer-to-peer lending.
- 8.7** So in this paper we only set out our proposals that mostly concern protections for **borrowers**.
- 8.8** In FSA CP13/7 we said we were considering applying the following rules to peer-to-peer platforms to protect the individuals and relevant persons that borrow through them:
- the platform must provide adequate explanations of the key features of the credit agreement to borrowers (including identifying the key risks) before the agreement is made (see CONC 4.4)
  - the platform must assess the creditworthiness of borrowers before granting credit (see CONC 5.5)
  - rules relating to 'financial promotions' (see CONC 3 (where applicable))
  - the platform must include in the agreement between borrower and lender 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 (see CONC 11.2)
- 8.9** In considering our approach to providing protections for borrowers, we have sought to balance the need to take account of the risks associated with this activity with the objective of developing a proportionate regulatory regime. We have also sought to afford borrowers similar rights and protections that they would be entitled to if the agreements that they enter into via the platforms were regulated consumer credit agreements entered into directly with a firm carrying on a lending business.

<sup>2</sup> See draft rules in CONC 8 (Appendix 2).

<sup>3</sup> The Principles for Businesses apply generally to a firm's ancillary activities.

<sup>4</sup> A natural person.

<sup>5</sup> A 'relevant person' in this context is either a) a partnership of two or three people not all of whom are bodies corporate or b) an unincorporated body which does not consist entirely of bodies corporate and is not a partnership.

**8.10** With a view to achieving these objectives, we propose to supplement our proposed rules to protect individual borrowers with some additional rules designed to address specific risks and to take account of the Government increasing the scope of the regulated activity relative to the position consulted on in FSA CP13/7.<sup>6</sup> Consequently, we now propose that:

- peer-to-peer platforms should have to meet the proposed requirements previously set out in FSA CP 13/7 (see above) – and in addition
- peer-to-peer lending platforms should be required to provide notices and information sheets to borrowers in arrears or default, directing them to sources of free and impartial debt advice (see CONC 7.18 to 7.20)
- equivalent rules should be applied to the peer-to-peer lending platforms that help borrowers get high-cost short-term credit as to those applied to lenders providing such credit (see CONC 6.7.17 to 26 and 7.6.12 to 14)
- peer-to-peer lending platforms should be required to provide a specific risk-warning to a borrower if the loan is secured against the borrower’s home – see CONC 4.4.5)
- equivalent rules should be applied to peer-to-peer lending platforms carrying on the following activities as to other consumer credit firms carrying on the same activities:
  - debt collection (see CONC 7)
  - the provision of credit information services (including credit repair) (see CONC 8.10)

**Q20: Do you have any comments on the rules that we propose to apply to peer-to peer lending platforms to protect borrowers?**

### Third-party tracing agents

**8.11** Third parties that trace borrowers who owe debts arising from consumer credit agreements or consumer hire agreements, but do not carry on any other regulated activity (including taking any other steps to collect debts), will be exempt from needing to be FCA-authorized or appointed representatives.

**8.12** The authorised firm (likely to be a lender or a debt collector) that outsources the tracing to the third-party would be held directly responsible by the FCA for the carrying on of that activity by the third-party tracing agent.<sup>7</sup>

<sup>6</sup> The rationale behind our proposed rules is set out and discussed in more detail in our consideration of responses to question 19 of FSA CP13/7 in Annex 1.

<sup>7</sup> See SYSC 8.1.6R on firms’ responsibilities concerning outsourcing.

## 9.

# Proposals for debt management firms that hold their clients' money

Debt management firms pose a risk to consumers as they hold their clients' money and make repayments to creditors on their behalf. To ensure these consumers are protected, we are proposing a number of rules for these firms, with additional rules for the larger firms.

In March we proposed to turn existing OFT guidance and industry codes for debt management firms into FCA rules and/or guidance. We also said we would consult further on additional requirements for the firms that hold the most client money including:

- annual independent external audits
- additional record keeping
- regular reconciliations
- client money oversight responsibilities for senior individuals within a firm

We are now proposing to apply all of these requirements to larger firms and to apply some of them to firms that hold lower amounts of client money. We decided to do this to ensure that similar systems and controls protect clients regardless of the size of firm they are dealing with.

In this chapter we summarise all of our proposals, including some new ones applicable to both small and large debt management firms.

We have drawn on the following sources when considering the overall regime:

- OFT guidance and industry codes (i.e. DEMSA and DRF codes);
- FSA CP13/7 proposals for larger firms;
- Extending some of the FSA CP13/7 proposals for larger firms to smaller firms; or
- New requirements for all firms that we consider necessary for consumer protection.

We always try to achieve a high standard of protection for clients of firms holding their money under the CASS regime, and many of the proposals in this paper are aligned to our existing regime for other types of business, though we have taken into account the specific risks involved in debt management activities. We view our proposals as necessary to protect consumers their money will not be covered by the FSCS. The proposals attempt to reduce uncertainty and delays in the event of a firm failure, but cannot prevent them completely.

### **Not-for-profit debt advice bodies holding client money**

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- 9.1** We are aware that some not-for-profit debt advice bodies also hold client money – some hold large sums of client money. In response to industry feedback, and in the interest of protecting all consumers, regardless of the type of firm they are facing, we propose that the client money requirements should apply to not-for-profit debt advice bodies.
- 9.2** As they are already subject to OFT guidance, we do not believe that extending our proposals should be overly burdensome on not-for-profit debt advice bodies.

### **Extending requirements for smaller debt management firms**

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- 9.3** In response to industry feedback and in the interest of consumer protection we now also propose that more requirements should be applicable to smaller debt management firms in addition to the proposed rules and guidance that are based on existing OFT guidance.
- 9.4** This is to ensure that clients of small debt management firms can receive an equivalent level of protection as clients of large debt management firms. Annex 1 summarises which requirements will be applicable to small or large debt management firms, or both.
- 9.5** We did not previously consult on a definition of smaller and larger firms. In this paper we are proposing that a firm that has held over £1m at any point during the previous calendar year or expects to do so in the current year should be categorised as a large firm. Please see the paragraph 9.21 under 'New Proposals' below for further detail.

### **Our proposals based on existing OFT requirements**

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- 9.6** In March we stated our intention to create rules and guidance based on existing OFT guidance. In line with this, we are now seeking feedback on requirements for firms to:
- segregate client money in 'ring-fenced' client bank accounts
  - pay a client any interest that is earned on the money held for that client
  - have adequate organisational arrangements in place to prevent client money being used for a firm's own account and minimise the risk of loss
  - ensure payments to creditors are made within five business days of receipt unless the firm has the client's prior consent for not doing so, having informed the client of the potential risks and implications
  - compensate clients for any losses accrued by late payments to creditors
  - return client money to a client within five business days of a written request from the client to withdraw from a debt management plan

## Additional proposals

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9.7 Detailed below are the additional proposed requirements for all debt management firms.

### **Annual independent client money audit**

9.8 All debt management firms holding client money would be required to have an annual audit, carried out by an independent external auditor, on how they comply with client money requirements. The results of the audit must be given to the FCA within four months of the firm's accounting year end. This would make it much more difficult for firms to hide things like improper use of client money.

### **Additional record keeping**

9.9 We are proposing that the following record keeping requirements would apply to all debt management firms, unless otherwise specified to be retained by firms for a minimum of five years.

#### ***Maintaining accurate records of client money holdings***

9.10 Under our proposals, firms would have to keep records that make it possible to distinguish the money they hold for one client from money held for another and from the firm's own money.

9.11 They would have to record all client money receipts in their internal records. In doing so firms must make sure that within five business days of receiving any payment of client money, their records clearly identify which of their clients made the payment or, where relevant, which client the payment is for (e.g. payments from third parties due to the client).

9.12 Our proposals would also require them to keep records of all the money they have paid to creditors and records of any verbal communication the firms have had with their clients and the clients' creditors.

#### ***Bank acknowledgement letters for client money bank accounts***

9.13 This proposal would require a firm to obtain a letter from every bank they use to deposit client money, in which the bank acknowledges that it will keep the firm's money separate from its clients' and that the bank has no right to use client money to cover any money a firm might owe to the bank. We have a letter template that firms can use to request this from a bank.<sup>1</sup>

#### ***Making records accessible if a firm fails***

9.14 Compliance with this proposal would require a firm to keep an up-to-date master document that would help an insolvency practitioner to find useful and necessary information about a firm's business and its senior personnel if the firm fails. This is to help reduce delays in the event of an insolvency and to try to speed up the return of money to clients.

#### ***Mandate rules***

9.15 Firms with a mandate (for example, a direct debit from a customer's bank account) would keep records and have controls in place to prevent misuse.<sup>2</sup>

<sup>1</sup> See draft instrument in Annex 2.

<sup>2</sup> In March we consulted on the mandate rules applying to all types of mandates, regardless of whether a mandate is received in writing. This could, for example, include certain information provided by a client (e.g. credit card details) over the telephone that a firm retains for its own records.

### Regular reconciliations

- 9.16** Reconciliations are an important part of the client money regime. They help to ensure that records are accurate. Under our proposals, all firms would need to perform regular checks of their client money records to correct any discrepancies they identify in their records, such as a shortage in a firm's client money account.
- 9.17** Large firms would need to carry out specific procedures that we will prescribe in our rules that consist of calculating their individual client's balances and comparing their own records with the records of the banks with whom they have client money bank accounts (i.e. by using bank statements). These procedures must be carried out as often as necessary, but at least every five business days. For example, a large firm that carries out daily transactions would also be expected to perform daily comparison of its own records with its bank records.

### Oversight of client assets

- 9.18** We are proposing that all firms must have a director or senior manager in the firm overseeing that firm's client money activities. We also propose that in large firms (including large not-for-profit debt advice bodies) this individual must be approved as part of the 'approved persons' process to perform this specific role within a debt management firm.
- 9.19** Please see Chapter 3 for more details on approved persons and to see how we have changed our proposals to suit the size of a debt management firm.<sup>3</sup>
- 9.20** Certain firms will have to keep a record of who is overseeing their client money activities.

## New proposals

### Categorising firms as large or small

- 9.21** We did not previously consult on the details of a distinction between smaller and larger firms. However, based on an assessment of the distribution of a sample of firms' holdings of client money, we propose that a firm that held over £1m at any point during the previous calendar year or projects to do so in the current year should be categorised as a large firm. Therefore a firm with client money holdings below £1m would be a small firm. The proposed £1m threshold also corresponds to a similar distinction for investment firms holding client money.
- 9.22** All firms would, at the start of every calendar year, be required to carry out an exercise to determine whether they are small or large based on their highest client money holdings, and then notify the FCA of their firm category. The same firm categories would apply to debt management firms and not-for-profit debt advice bodies.

### Appointed representatives

- 9.23** Under our proposals, appointed representatives of debt management firms (see Chapter 3 for details on appointed representatives) may handle client money in the form of cash or cheques, as long as they pay them into an authorised firm's client money bank account within one business day of receiving them. They will not, however, be permitted to hold client money in their own bank accounts and must instead have processes whereby any automated payments (e.g. debit card payments) are made by their client directly to an authorised firm's client money bank account.

<sup>3</sup> The way we apply approved persons requirements to banks could change or be delayed as we further consider some recommendations by the Parliamentary Commission on Banking Standards (PCBS). This means we may need to consult again on revised proposals.

**9.24** A firm that has appointed representatives may have difficulty in properly overseeing how well they handle client money, which the principal has a duty to protect. Due to risks like late segregation and poor record keeping, we consider our appointed representative proposals to be proportionate and in keeping with the FCA's general approach to appointed representatives in relation to client money.

**Large firms: choosing an appropriate bank**

**9.25** Our proposals require large firms to choose appropriate banks to segregate client money and make sure that they do not deposit too much client money with any one bank and to make records of their decisions. This is to ensure that appropriate due diligence is undertaken by firms when responsible for larger amounts of client money.

**How money will be returned to clients if a firm fails**

**9.26** Our proposed distribution rules will require the administrator of a failed firm to return client money to clients. The administrator will be required to pool all client money together and then calculate each client's entitlement to that pool. Where there is less money available in the pool than there is meant to be, a shortfall will arise. This shortfall will be shared rateably<sup>4</sup> by clients based on their entitlement to the pool.

**9.27** Our client money requirements will reduce the delays and losses suffered by customers when a firm fails, but they cannot prevent them completely. Delays between a firm failing and customers getting their money back will depend on things like the state of the failed firm's books and records, and how large and complex the firm's business was, etc.

**9.28** We explain in Chapter 11 that customers of failed debt management firms will not have access to the Financial Services Compensation Scheme. This reinforces the need for robust client money arrangements.

**9.29** Please also see Annex 2 for a summary of all our proposals and their application to firm's depending whether they are large or small.

**Q21: Do you agree with our proposals for debt management firms and not-for-profit debt advice bodies that hold client money? If not, which aspects of the regime do you disagree with and why?**

**When will the new rules take effect?**

**9.30** In this consultation we are proposing when the rules will come into effect. For CASS, we are proposing delayed implementation, which means that CASS will not apply to firms with an existing OFT licence and interim permission until they become fully authorised (which could be as late as 2016). In the interim, they must comply with the existing OFT guidance.

<sup>4</sup> A firm may find that the total client money it has available is less than the amount it is meant to have. The difference between these two amounts is called a 'shortfall'. So if one particular client is entitled to 1% of the money the firm is meant to have and there is shortfall they will receive 1% of the money it has available. Shortfalls can be caused by a firm not segregating enough client money into its client money bank account(s) or the cost of distribution that would also be paid for out of the client money pool.

- 9.31** For new entrants into the market, we are proposing that firms are subject to the new rules immediately after they are authorised. This is because they will have the benefit of foresight of the rules coming into force, and will not have to adjust existing business models and business practices in order to comply. In addition, we do not think it would be appropriate to ask firms to meet the OFT guidance for an interim period before then changing to the newly proposed rules as this could create more confusion and uncertainty.

**Q22: Do you agree with our proposed implementation timetable? If not, please give reasons.**

# 10.

## New proposals for second charge loans

A second charge loan is a loan that is secured on a consumers' property where that customer already has a mortgage.

In March, we stated that the consumer credit regime for second charge loans will remain largely unchanged and be in line with the regime for other forms of consumer credit.

At the same time we also considered the fact that firms providing second charge loans will be subject to a different regulatory regime in the longer term when the Mortgage Credit Directive is implemented.

In this chapter we propose amending our reporting requirements for firms providing second charge loans (for more information on our reporting requirements, see Chapter 4).

### Proposed changes to our reporting requirements

- 10.1** We are proposing to reduce the reporting requirements on firms providing second charge loans. This is to ensure budgets are kept to a minimum during the interim period.
  - 10.2** Some firms are currently required to report their second charge data to us because they are authorised in relation to first charge mortgages. These requirements will continue to ensure the continuity of data, but there will be no new burdens on the firms in relation to reporting.
- Reducing the burden for firms**
- 10.3** We are consulting in Chapter 4 on reporting requirements that will apply to consumer credit firms once they are fully authorised for their consumer credit activities.
  - 10.4** We are proposing that other firms will not have to report data to us regarding their second charge loans (other than in respect of complaints for firms once fully authorised), to minimise burdens on the firms in the interim period until the Mortgage Credit Directive is implemented.
  - 10.5** However, we may make ad-hoc data requests to second charge firms where we feel it is necessary to help us supervise them. We will revisit and consult on the routine reporting requirements for second charge firms as part of the longer-term regime.

**Exemption for complaints reporting**

- 10.6** An exemption to our proposed approach is the complaints reporting requirements outlined in Chapter 11.
- 10.7** As the same complaints reporting requirements will apply to all FCA firms regardless of which products they offer, fully authorised second charge firms will have to report their complaints to us.
- 10.8** Second charge firms with an interim permission will, however, be exempt from this.

**Transitional changes to our MLAR guidance**

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- 10.9** Lenders or administrators of regulated mortgage contracts (first charge mortgages) currently have to complete the Mortgage Lending and Administration Return (MLAR). As part of this, they provide us with information on the second charge lending they carry out.<sup>1</sup>
- 10.10** We will consult in future on how second charge mortgages should be reflected in the MLAR. Until then, we propose that firms should continue to report second charge loans as normal so the data remains the same for now.
- 10.11** We will update the MLAR guidance to make this clear.<sup>2</sup>

**Q23: Do you agree with our suggested amendments to the reporting requirements for second charge loans?**

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<sup>1</sup> This information is currently reported in the 'non-regulated' categories on the return.

<sup>2</sup> This can be found in Appendix 1.

# 11.

## Complaints to the ombudsman service and redress for consumers

Customers of firms authorised by the FCA or the PRA who are unhappy with the way their complaint has been handled will have the right to complain to the Financial Ombudsman Service (the ombudsman service) who will then investigate.

The Financial Services Compensation Scheme (FSCS) is the UK's statutory compensation scheme for customers of financial services firms. It can pay compensation to customers if a firm is unable, or is likely to be unable to, pay claims against it.

This chapter sets out our updated proposals regarding these bodies and consumer credit firms.

The powers to make rules relating to the ombudsman service are shared between the FCA and the ombudsman service. So this chapter is issued jointly by the FCA and the ombudsman service and, where relevant, references to 'we' in relation to the ombudsman service refer to the FCA and the ombudsman service.

### The ombudsman service jurisdictions

- 11.1** The ombudsman service currently has three 'jurisdictions' under which it can consider consumer complaints.
- Compulsory Jurisdiction (CJ)
  - Voluntary Jurisdiction (VJ)
  - Consumer Credit Jurisdiction (CCJ), which will be abolished on 1 April 2014
- 11.2** These jurisdictions cover different types of firms.<sup>1</sup>
- 11.3** When the regulation of consumer credit is transferred to the FCA, all consumer credit activities will be covered by the CJ, like other regulated activities, and the CCJ will be abolished.

<sup>1</sup> For more information on what the jurisdictions cover and for which type of firm, see FSA CP13/7, page 86.

- 11.4** Complaints relating to the behaviour of consumer credit firms before 1 April 2014 will continue to be covered by the ombudsman service.<sup>2</sup>

### Our proposal for micro-enterprises<sup>3</sup>

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- 11.5** In the Consumer Credit Jurisdiction (CCJ), the following types of micro-enterprises are not eligible to complain to the ombudsman service<sup>4</sup>:

- a body corporate
- a partnership consisting of more than three persons
- a partnership, all of whose members are bodies corporate
- an unincorporated body that consists entirely of bodies corporate

- 11.6** Micro-enterprises that fall into these categories can, however, refer a complaint to the ombudsman service in the Compulsory Jurisdiction (CJ). Consistent with the current approach in the CJ, we propose that these micro-enterprises will be eligible to complain to the ombudsman service about consumer credit activities from 1 April 2014 on the abolition of the CCJ.

#### **Q24: Do you agree with our proposal to allow all micro-enterprises to complain to the ombudsman service?**

### Our proposal for not-for-profit debt advice

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- 11.7** In FSA CP13/7 we proposed to allow not-for-profit bodies providing debt advice to 'opt in' to the VJ. However, based on feedback and further analysis, we now propose that these firms should be covered by the CJ.

- 11.8** Not-for-profit debt advice bodies provide a valuable service for some vulnerable consumers. The only consumer credit activities they carry on are debt counselling, debt adjusting<sup>5</sup> and providing credit information services. The ombudsman service has received very few complaints to date about the not-for-profit debt advice bodies that are currently subject to the CCJ.

- 11.9** Continuing this kind of arrangement through the CJ could ensure consumer confidence and enhance consumer protection and access to redress, as the customers of all not-for-profit debt advice bodies will have access to the ombudsman service, like the customers of other firms. However we need to balance the need for consumer protection against the need to not put unnecessary constraints on these bodies.

- 11.10** So we also propose to consult in our Fees consultation paper on not applying an ombudsman service general levy to these bodies. The ombudsman service is also considering consulting in

<sup>2</sup> The previous eligibility rules in the CCJ will continue to apply where the complaint was made before the transfer and the CJ eligibility rules will apply where it was made after the transfer. This is set out in a Treasury Order and in the draft rules in DISP 2.1.2G and 2.3.2-AG in Appendix 2.

<sup>3</sup> A micro-enterprise is an enterprise that employs fewer than ten people and has a turnover or annual balance sheet that does not exceed €2 million.

<sup>4</sup> We will do this by removing the current exclusion of some micro-enterprises in DISP 2.7.9R(3) as shown in the draft rules in Appendix 2.

<sup>5</sup> Negotiating with creditors.

January 2014 on whether or not to apply case fees to them.<sup>6</sup> We explained how the ombudsman service is funded in the FSA CP13/7.

**Q25: Do you agree with our proposal to include not-for-profit bodies providing debt advice in the Compulsory Jurisdiction?**

**Ombudsman service general levy**

- 11.11** We propose to consult in our Fees consultation paper on our proposals for the ombudsman service general levy for consumer credit activities.

**Access to the Financial Services Compensation Scheme (FSCS)**

- 11.12** At the moment we do not propose to extend FSCS cover to consumer credit activities, but we will review this in 2016, when all firms should be fully authorised.
- 11.13** In particular we will look at whether there should be FSCS cover for the debt management sector, as this is a sector where client money is most at risk and companies may give unsuitable advice.

**Recording, reporting and publishing complaints from consumers**

- 11.14** In FSA CP13/7 we proposed that consumer credit firms that are not currently FSMA authorised should record, report and (where appropriate) publish a relatively small amount of complaints information.
- 11.15** We propose that from 1 April 2014 consumer credit firms that have not to date been FSMA authorised will need to record every complaint they receive, including how they resolved it, and keep the record for three years.<sup>7</sup> This shouldn't put too much additional burden onto firms, as most of them will already have complaints processes in place.<sup>8</sup> Consumer credit firms that are FSMA authorised are already subject to these requirements.
- 11.16** Table 11.1 summarises our proposals on how often firms should report and publish complaints, based on the activities they carry out.<sup>9</sup>
- 11.17** We propose that these requirements will not apply to:
- consumer credit firms with only an interim permission
  - credit related regulated activities of existing FSMA-authorised firms with only an interim variation of permission. Until they have obtained a full variation of permission, we propose these firms will continue to report and publish complaints in accordance with current requirements

<sup>6</sup> We believe this is a good outcome for the consumers that use these bodies. We are grateful to the not-for-profit groups for their support and co-operation in developing our proposals.

<sup>7</sup> DISP 1.9.1R.

<sup>8</sup> It is in licensees' interests to retain records of complaints so that these can be used to help the FOS if necessary (DISP 1.1.16G).

<sup>9</sup> The rules are contained in DISP 1.10 and 1.10A in the draft rules in Appendix 2.

Table – 11.1

	<b>Banking and credit cards e.g. credit cards and overdrafts and home finance e.g. first and second charge lending and unregulated products.</b>	<b>Other activities e.g. other lending, credit broking, debt adjusting where annual revenue is more than £5m from credit-related regulated activities</b>	<b>Other activities e.g. other lending, credit broking, debt adjusting where annual revenue is less than or equal to £5m from credit-related regulated activities</b>	<b>Lower risk activities carried on by firms with limited permission (unless that firm is a not for profit debt advice body holding £1m or more in client money) e.g. consumer credit lending where the firm's main business is selling goods/non-financial services<sup>10</sup></b>
<b>Reporting</b>	Report every six months: Total complaints outstanding at start of reporting period per product/service grouping (e.g. banking): complaints closed broken down by time to close complaint, complaints upheld by the firm, and total redress paid. Per product/service (e.g. credit cards): complaints opened broken down by different aspects of product/service, e.g. advising, selling and arranging, terms and disputed sums/charges.	Report every six months per activity (eg home credit loan agreements, credit broking, debt management): Total complaints outstanding at start of reporting period, complaints received, complaints closed, complaints upheld by firm and total redress paid.	Report once a year per activity : (eg home credit loan agreements, credit broking, debt management): Total complaints outstanding at start of reporting period, complaints received, complaints closed, complaints upheld by firm and total redress paid.	Annual reporting of the number of complaints received. <sup>11</sup>
<b>Publishing<sup>12</sup></b>	Six monthly publishing per product/service grouping of complaints opened, closed, closed within eight weeks, and closed and upheld by the firm if report 500 or more complaints in six months.	Six monthly publishing per product/service grouping of complaints opened, closed, and closed and upheld by the firm if report 500 or more complaints in six months.	Annual publishing per product/service grouping of complaints opened, closed, and closed and upheld by the firm if report 1,000 or more complaints in 12 months.	Annual publishing of number of complaints received, if report 1,000 or more complaints in 12 months.

<sup>10</sup> For guidance on the activities that firms with limited permission can carry on see COND 1.1A.5AG in the draft rules at Appendix 2.

<sup>11</sup> Unregulated as well as regulated. This will include complaints about activities carried on before the transfer to the FCA.

<sup>12</sup> Guidance in DISP recommends that firms publish additional information alongside their complaints summaries to relate the number of complaints to the scale of the firm's relevant business. Recommended metrics for this purpose will be based on the tariff base on which we will consult in the October Fees CP.

### Changes to the complaints reporting form

- 11.18** We propose to make minor changes to the existing complaints form and add a new section.<sup>13</sup> So part A will be the existing form and part B will cover the new consumer credit activities.
- 11.19** Firms with a limited permission (apart from not-for-profit advice bodies that hold £1m or more in client money) will not have to complete part B, but they will have to annually report the number of complaints they have received.<sup>14</sup>
- 11.20** Existing FCA-authorized firms may need to complete both parts A and B. We expect it to be mostly the large consumer credit firms that need to complete both parts.
- 11.21** Table 11.2 shows what part B will look like.

#### Q26: Do you agree with our proposals on recording, reporting and publishing complaints?

**Table – 11.2**  
**PART B**

Activities	Total complaints outstanding at reporting period start date	Complaints Received	Complaints Closed	Complaints Upheld by firm	Total Redress paid £
<b>Lending</b>					
Debt purchasing <sup>15</sup>					
Hire purchase conditional sale agreements					
Home credit loan agreements					
Bill of sale loan agreements e.g. logbook lending					
Pawnbroking					
High cost short term credit					
Other lending					
<b>Credit Broking</b>					
Debt Management activity					
Debt collecting					
All other credit-related activity <sup>16</sup>					

<sup>13</sup> Part A will cover credit cards and regulated and unregulated home finance products and it will be extended to expressly cover overdrafts.

<sup>14</sup> SUP16.12.29C and Annex 35AR, CCR007.

<sup>15</sup> Including complaints in relation to the underlying debt that has been purchased but not complaints about the collection of that debt.

<sup>16</sup> Unregulated as well as regulated. This will include complaints about activities carried on before the transfer to the FCA.

## 12. Enforcing our rules and tackling financial crime

One of the ways we are able to protect consumers is by using enforcement action to discourage firms and individuals from wrongdoing or from committing, or facilitating financial crime.

We have much stronger enforcement powers than the OFT.

Our approach to enforcement and our policy and procedures for imposing penalties is set out in our Handbook – specifically in the Enforcement Guide (EG) and our Decision Procedure and Penalties Manual (DEPP). In this chapter we set out our proposals to amend these sections.

We also cover how we expect consumer credit firms to tackle financial crime.

### Amending our enforcement rules

We propose to apply the same general enforcement approach to consumer credit activities as we apply to other regulated activities.<sup>1</sup>

So we will be able to investigate and take enforcement action against any authorised firm that breaks our rules. As firms that carry out regulated consumer credit activities will need to be authorised by us or have interim permission (or act as an appointed representative by someone who is authorised), our existing policies and procedures will automatically apply to them, without the need to amend our Handbook.

However, we are adding a new part to the Enforcement Guide in our Handbook to apply our penalties policy to any disciplinary action we take against firms in respect of retained elements of the CCA.

The way we investigate, enforce and prosecute these breaches will also be the same as for other regulated activities.

The Regulatory Decisions Committee (RDC) will decide on what disciplinary action we take against firms that breach retained elements of the CCA.<sup>2</sup>

- 1 We plan to liaise closely with other bodies when carrying out enforcement action, such as Local Authority Trading Standards Services and the Illegal Money Lending Teams, who will retain powers to investigate and prosecute retained offences under the CCA and specified offences in FSMA that relate to credit activities.
- 2 This is reflected in the amendments made to DEPP 2 Annex 1 (see Appendix 1).

## Tackling financial crime

### Supervision under the Money Laundering Regulations

From 1 April 2014 we will be responsible for supervising the consumer credit firms that are subject to the Money Laundering Regulations. These firms will not have to register separately for this or pay an additional fee as they do now to the OFT.

We will publish more information about these arrangements in due course.

### Financial crime

All consumer credit firms must comply with legal and regulatory obligations to deter and detect financial crime. This includes money laundering. We will require all consumer credit firms to establish and maintain appropriate and risk-sensitive policies and procedures to reduce the risk that they may be used to further financial crime.<sup>3</sup>

In addition, most consumer credit firms that are subject to the Money Laundering Regulations will also have to comply with our anti-money laundering provisions.<sup>4</sup> Our rules require firms to identify, assess and mitigate the risk of money laundering in their business. They also require firms to appoint a money laundering reporting officer and allocate overall responsibility to establish and maintain effective anti-money laundering systems and controls to a senior manager.

We already have regulatory guidance that sets out how firms can meet their financial crime obligations.<sup>5</sup> We will update this guidance to take account of consumer credit firms.

We will work alongside and share information with a range of other organisations – such as Local Authority Trading Standards Service, the Department of Enterprise, Trade and Industry of Northern Ireland, police forces, the Serious Organised Crime Agency and other agencies – to help us detect and take action against any financial crime risks.

We run a whistleblowing service so anyone can expose misconduct in the industry.

Contact us on 020 7066 9200 or email us at [whistle@fca.org.uk](mailto:whistle@fca.org.uk).

<sup>3</sup> Rule SYSC 6.1.1R of the FCA Handbook: <http://fshandbook.info/FS/html/handbook/SYSC/6/1>

<sup>4</sup> Chapter SYSC 6.3 of the FCA Handbook: <http://fshandbook.info/FS/html/handbook/SYSC/6/3>

<sup>5</sup> Financial Crime: A Guide for Firms: <http://fshandbook.info/FS/html/handbook/FC>

## 13. Next steps

Please send us your comments by 3 December 2013. We will review all your responses and publish our feedback on them.

We plan to publish a policy statement in February 2014, ahead of the transfer of consumer credit regulation from the OFT on 1 April 2014. This will include our final rules and guidance where we have consulted on draft Handbook material in this paper.

Additional information relating to authorisation and periodic fees will be available in the October consultation paper relating to fees. Further information on the new regime, including how to apply for interim permissions, is available on our website<sup>1</sup> and we will be updating this regularly.

**Table 13.1 – Timetable for future FCA papers and announcements**

<b>Expected date</b>	<b>Content</b>
October 2013	Consultation paper on fees, including authorisation fees for consumer credit firms and how we propose to calculate periodic fees
October 2013	Consultation paper on our approach to regulated crowdfunding, including peer-to-peer lending
Late 2013	Consultation on plain language guidance on the new consumer credit regime for firms and other stakeholders
Late 2013	Consultation on any further consequential changes to the handbook
Early 2014	Announcement of dates (starting in autumn 2014) by when specific types of firms with interim permissions must apply for full authorisation
February/March 2014	Policy statement in response to this consultation, including final rules for the new regime
February/March 2014	Feedback on responses to the consultation paper on our approach to regulated crowdfunding, including peer-to-peer lending
March 2014	Final version of plain language guidance on the new consumer credit regime for firms and other stakeholders
March 2014	Fees: proposals for periodic fee rates for 2014/15
Around the time of transfer (April 2014)	FCA paper on key risks in the market and our priorities for intervention

<sup>1</sup> [www.fca.org.uk/firms/firm-types/consumer-credit/consumer-credit-interim](http://www.fca.org.uk/firms/firm-types/consumer-credit/consumer-credit-interim)

## Stakeholder engagement

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We will proactively engage with all industry stakeholders throughout the consultation period, in particular on how we are proposing to carry across the OFT conduct standards, and in the lead-up to the transfer. It is important that all consumer credit firms understand the implications for their activities. We will try to do everything we can to help them understand the requirements placed on them and to transfer to the new regime.

We also want to engage with consumers and consumer groups and ensure that they have an opportunity to express their views and comment on our proposals. We are meeting regularly with consumer bodies, and will continue to do so.

Between October 2013 and March 2014 we will be engaging with industry, consumer groups and consumers. In many cases this will involve speaking at engagements organised by trade associations but there will also be a programme of events and roadshows so those that are interested can understand more about what is proposed and contribute their views.

## Post-implementation reviews

In line with our normal practice, we will conduct a review of our overall approach to the transfer in due course. We will take particular account of the effects the new regime has had on competition. We will also undertake a review by 2019 of the retained provisions of the CCA regime.

## Memoranda of understanding

As part of our preparations for the transfer we will be updating the memoranda of understanding we have with other bodies to cover our new responsibilities for consumer credit. We also plan to create new structures for effective liaison, including with the Competition and Markets Authority (CMA), LATSS and DETINI.

We value the role of LATSS and DETINI in 'frontline' intelligence gathering on consumer credit and will work with them to make the most of opportunities to share intelligence. This will, for example, help them and us identify and tackle financial crime in consumer credit businesses. We will also work closely with them as sources of information in ongoing event-driven supervision.

## Part B – Policy statement on the rules we consulted on in CP13/7: high-level standards

- 1.1** In FSA CP13/7, we consulted on high-level proposals for the new consumer credit regime. This included draft Handbook text applying the high-level rules in the PRIN, SYSC and GEN sections of our Handbook to consumer credit firms and disapplying some of the new requirements for firms that will have interim permissions as well as FSMA permissions, or that will only have interim permissions from.
- 1.2** We proposed that the following high-level and interim permission rules should apply to firms providing consumer credit with effect from 1 April 2014.

### PRIN

- 1.3** Our PRIN standards are 11 fundamental principles that firms must comply with at all times (see Table B1). With the exception perhaps of Principles 3 and 4, we expect that well-run firms will be familiar with the concepts found in our principles as similar concepts already exist in the CCA licensing test and the OFT fitness guidance (which is taken into account in deciding whether a firm is fit to hold a licence). We proposed to apply the principles to all authorised consumer credit firms and those with interim permissions.

### GEN

- 1.4** We proposed to apply GEN without amendment, with the exception of status disclosure, where firms would be required to make it clear to consumers who they were regulated by and whether they had an interim permission, were fully authorised or had limited permission (for lower-risk activities). There would also be provisions ensuring that our status disclosure rules would not breach the provisions in the Consumer Credit Directive on pre-contract and contractual information. We did not propose to apply our sourcebook on Training and Competence, as we proposed to rely on the general effect of the principles.

### SYSC

- 1.5** Our SYSC standards expand on Principle 3, which states that ‘a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk-management systems’ and describe what we will expect in practice. We proposed to apply systems and controls rules and guidance to all authorised consumer credit firms and those with interim permissions. This included requiring consumer credit firms that are within the scope of the Money Laundering Regulations to comply with the financial crime rules in SYSC 6.3 – for example, the requirement to have a Money Laundering Reporting Officer. Firms with limited permission would need to have a person responsible for the apportionment of responsibilities function. Debt management and credit repair firms would need to have a compliance officer.<sup>1</sup>

<sup>1</sup> The way we apply approved persons requirements to consumer credit firms could change or be delayed as we further consider recommendations by the Parliamentary Commission on Banking Standards (see chapter 3).

**CONC**

- 1.6** We proposed to disapply to firms with interim permission a small number of new rules in SYSC, relating to the appointments of certain persons and to fees. These rules will be located in the new consumer credit sourcebook – CONC.

**Glossary**

- 1.7** There will be some amendments required to the glossary to reflect the new consumer credit activities.

**Table B1 – 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

- 1.8** Having taken account of the feedback we received (set out below), we have now decided to make the rules we consulted on in PRIN, SYSC and GEN, with one change.<sup>2</sup> That is that consumer credit firms will not have to disclose whether they have interim or limited permission in their status disclosure on letters and electronic equivalents. The standard rule in GEN 4.3 will apply from 1 April 2014. Our detailed rules are set out in Appendix 2.

<sup>2</sup> We have also made minor changes to the definitions to be added to the glossary together with minor drafting changes.

## Detailed feedback and our response

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### ***Q14: Do you agree with our proposals that the new high-level conduct requirements should apply from 1 April 2014?***

- 1.9** We received a significant number of responses to our proposals on the high-level principles. The majority of responses were in favour of the proposals.
- 1.10** A number of respondents were concerned with the proposal requiring firms to make it clear to consumers who they are regulated by and whether they have an interim permission, are authorised or have limited permission. Respondents indicated that this would be confusing to consumers, add unnecessary administrative burdens and result in firms incurring additional costs.
- 1.11** Respondents also raised concerns that principle-based regulation will be a new concept for many consumer credit firms. Several responses indicated that smaller firms will have less sophisticated internal systems, and could have problems complying with Principle 3. Respondents wanted more clarity about what the FCA would reasonably expect from these firms to comply. Respondents also asked for a suitable transitional period to be introduced, with periods of between 12 and 24 months being suggested.
- 1.12** Some respondents raised additional concerns in relation to SYSC, indicating that some of the detailed requirements contained here could result in extensive system changes. Furthermore, some of the requirements could result in problems in relation to fixed-term contracts for outsourced activities. Some respondents suggested that a transitional period, of up to 24 months, should be introduced for compliance with SYSC.
- 1.13** A few respondents stressed the considerable challenge of the timetable and the limited time in which they would have to make systems changes to comply with any new or different rules. This was particularly a concern for firms not currently regulated by the FCA or PRA. These firms will also be dealing, for the first time, with the FSMA regime more generally, including rules contained in PRIN and SYSC.

## Our response

As the majority of respondents were, in general, supportive we are largely taking forward the proposals outlined in FSA CP13/7. However, taking into account some comments, we have made some changes to our original proposals.

We do not propose to amend our approach in relation to our 11 Principles for Businesses being applicable from 1 April 2014. The 11 principles display, at a high level, the fundamental obligations that firms must comply with under the FCA regulatory regime. We do not believe that a transitional period for complying with these would be desirable given our intention to increase protection for consumers. We understand that firms may wish to review their businesses in light of the requirements, however we believe that much of the concepts found in the principles are also found in current OFT guidance. Therefore, firms that are currently compliant with the CCA rules and OFT guidance should not have to make substantial changes to their businesses.

We do not propose to amend our approach to applying SYSC. This will be applicable from 1 April 2014, and no transitional period will be granted for compliance. We believe that, by making the rules now, we are giving firms sufficient notice to be able to become familiar with what is required ahead of their implementation on 1 April 2014. Furthermore, the requirements contained in SYSC reflect the nature, scale and complexity of the firm's business and the risk that the activity potentially poses to consumers.

We believe that it is important for firms to make consumers aware of who they are regulated by.

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- 1.14** We proposed in FSA CP13/7 that firms should make it clear to consumers who they are regulated by and whether they have an interim permission, are authorised or have limited permission, except where disclosure about regulation is required by the CCD<sup>3</sup>,
- 1.15** As a result of the comments received, we have decided to amend our approach to status disclosure, so that firms who have interim permission only have to make one change to their status disclosure to customers.
- 1.16** From 1 April 2014, UK-based firms with interim permission will be required to state that they are either:
- authorised and regulated by the Financial Conduct Authority
  - authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority
- 1.17** This is the standard status disclosure requirement that all FSMA-regulated firms must comply with, and removes the requirement that firms must tell consumers the nature of their permission/authorisation. We do not believe that the made rules differ significantly from the draft rules in the previous consultation.

<sup>3</sup> Pre-contract and contractual information (Articles 5, 6 and 10).



# Annex 1

## Detailed feedback on FSA CP13/7

### Introduction

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1. In this Annex we summarise the feedback we received to our proposals in FSA CP13/7 and set out our policy response. In the main chapters of this paper, we describe the main features of the new regime and the issues and draft rules on which we are now consulting.

### The proposed framework for the new regime

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2. In Chapter 2 of FSA CP 13/7 we set out our proposed broad framework for the new regime. In this chapter, we set out the feedback we received and our response.

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

3. There were a large number of responses to this question. Most agreed with the framework, including all consumer groups' responses. Several agreed in part but were concerned about certain issues, with just a small number of responses opposing the framework, largely preferring the current OFT regime.
4. The concerns covered a large number of topics. Some respondents were concerned about the extent of the regulatory burden under the new regime, which they stated was disproportionate to the risks. They felt the increased cost on firms would lead to market exit, pushing consumers into the illegal lending market. Many were also concerned with the short time frames for the transfer.
5. More specific concerns were also raised. Some lenders suggested certain activities were inappropriately captured within the FSMA regime, since the risks of that activity were minimal. This issue was raised as regards small business loans and peer-to-peer lending. Concerns were raised around the extent of new regulation for the debt management sector, which may lead firms to exit the market.
6. A few responses highlighted the consequences of capturing peripheral lending or debt activities within the new regime leading to excessive regulation, for example, in relation to Insolvency Practitioners, and Residential and Social Landlords.

### Our response

As set out in FSA CP 13/7 consultation paper, we will target resources at areas of higher risk where the benefits to consumers are greater by applying a two-tier regime. The transition will be smoothed by the Government's introduction of an interim permission regime together with some transitional arrangements.

We intend to follow the approach set out in FSA CP 13/7. We have made a few changes in terms of what activity sits in which class and in terms of exemptions but the framework will remain largely the same as was proposed.

We plan to carry out a post implementation review and undertake a review of the retained provisions of the CCA by 2019.

7. In chapter 2 of FSA CP 13/7 we said that the OFT Compliance Review and the Bristol University report had highlighted serious issues in the short term high cost credit market (payday lending). We committed to taking a robust approach to tackling problems in this market when we took over regulation in April 2014 and to look at whether there are any gaps in OFT standards that require new FCA rules or guidance.
8. We did not ask any specific questions on this sector. Some respondents did comment on it however.
9. Consumer groups and debt advice agencies identified persistent poor behaviour and significant consumer detriment. They felt specific new rules were required in this sector.
10. In terms of what interventions were required, responses varied. Ideas included finding alternatives to disclosing the APR, better information to consumers in risk warnings and signposting debt advice, through to mandating stronger affordability checks.
11. There was a strong feeling that more needed to be done to deal with the way firms dealt with customers who were showing signs of indebtedness. Some respondents felt there were some useful provisions within the codes, for example limits on rollovers. Yet, consumer groups felt that what provisions were in the Codes were not sufficiently monitored or enforced. These conclusions reflect the OFT's recent compliance review into the sector.<sup>1</sup> There was wide support therefore for putting provisions from the Codes into FCA rules to ensure such provisions could be enforced.
12. However, most felt the FCA should go further in strengthening consumer protection beyond the provisions in the Code covering both the supply of credit and how firms dealt with their customers.

### Our response

We agree that there are gaps in the current rules for high-cost short-term credit and are now consulting in Chapter 6 of this paper on proposals to fill these.

<sup>1</sup> [www.offt.gov.uk/shared\\_offt/Credit/oft1481.pdf](http://www.offt.gov.uk/shared_offt/Credit/oft1481.pdf)

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

- 13.** Most respondents commented on this question and the vast majority agreed with the Government's and our proposals, although several responses were not supportive.
- 14.** Of those who were opposed some stated the approach was inherently too blunt to accurately reflect risks posed to consumers by different firms. Others thought that it would incentivise firms to move to lower risk activities where they may behave in ways not beneficial to consumers. Others disagreed with the split, or suggested changes to the activities in each category.
- 15.** Some respondents suggested that the following activities posed minimal risks to consumers and should be in the lower risk category companies:
- debt recovery
  - insurance – either paying by instalments, or where the insurer does not employ any debt collection
  - brokering
  - vehicle leasing
  - credit searches as part of credit information services
  - Debt advice or adjusting from a private entity but where the advice is ancillary to the main activity – for Registered Social Landlords, credit unions, Insolvency Practitioners or employers
- 16.** Some respondents thought the following activities should be higher risk:
- all home based credit activities, including brokering
  - holding client money
  - secondary brokering
  - hire purchase
  - second charge mortgages
- 17.** Finally, a few responses identified concerns about possible distortions to competition between firms and not-for-profit organisations in debt advice. These responses suggested it was wrong to place them in different categories when the risks to consumers were the same. One response made the same point as regards retail and mail order, as that was a direct competitor to home credit and the risks posed were similar.

### Our response

There have been some minor changes to the framework but it remains fundamentally unchanged. Lower and higher risk activities are now enshrined in legislation. In response to the concerns about vehicle leasing, the Government has included broking of **vehicle leasing** within the limited permission regime.

**Green Deal broking** has also been added to the list of lower risk activities.

The Government has maintained its position that **not-for-profit firms that provide debt advice** should be categorised as lower risk. Nevertheless, these firms will be subject to the same comprehensive conduct of business rules as profit-seeking debt management firms as consumers should be able to expect appropriate debt advice and high standards of conduct from both profit seeking and not-for-profit firms.

The Government's position on **secondary credit broking** has not changed and this will remain a lower risk activity.

The Government is considering the appropriate regulatory arrangements for local authorities that carry on unsecured lending. We have considered possible alternative terminology to describe 'limited permission' firms but, given the very limited response on this issue and lack of good alternative suggestions, we are not minded to change the term. However, it will not be used in firms' disclosure of their regulatory status, or in the FCA Register, so potential to confuse consumers is limited.

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

18. Respondents who provided a view on the competition question were quite evenly split, with just over half agreeing or agreeing in part that our proposals minimise any adverse impact on competition.
19. We identified several themes in the responses on competition, these were:
20. **The interim permissions and full authorisation process may act as a barrier to entry.** Several respondents mentioned that the limited amount of time to apply for full authorisation, and the time taken for the authorisation process introduces a barrier for new firms to enter the market. One respondent argued that the need to apply for authorisation will act as a barrier to entry for firms with an interim permission who want to start a new credit activity.

### Our response

We accept that the need for firms to have appropriate regulatory permissions to carry out consumer credit activities is, by construction, a barrier to entry to the consumer credit market. However there is a current licensing regime under the CCA. Clearly a barrier to entry is needed if we are to ensure that firms, for example, with harmful business models do not enter consumer credit markets. However, the FCA has also taken care to construct its authorisations regime to mitigate the extent of this barrier. For example, having a limited permission category for some firms should help to ease the regulatory transition and entry for these businesses. In addition FSMA has legislative deadlines for determining authorisations which the FCA has to comply with, so a completed application has to be determined within six months. In relation to the full authorisations process, we also expect that as the regulatory transition progresses, the time taken to process applications should fall i.e. once the new regulatory system is bedded down, authorisations processes will accelerate and the barriers to entry reduce.

- 21. Increased regulatory costs and fees will lead to market exit, particularly among smaller firms.** This point was made by a range of respondents, for example that there would be significant exit of smaller lenders and that this would increase market concentration, reduce choice and competition on price. Also, some respondents thought that the market exit in the point of sale credit sector was not likely to be filled by other larger lenders, and that this would have detrimental effects on competition and consumers. Some argued that there the regime would lead to further consolidation among debt management firms. Insolvency practitioners were also specifically identified as groups that may face a significant increase in regulatory burdens which could lead them to exit.

### Our response

In their revised CBA, Europe Economics have re-estimated the market exit they expect in different segments, in light of new evidence and refinements to the policy proposals. Their revised exit estimates show the most significant exit from the regulatory transfer is expected among payday lenders, due to the policy proposals being introduced for these. However, as we set out in Chapter 6, we believe that these impacts will reflect a necessary adjustment as firms act to stop targeting borrowers who cannot afford to repay their loans. In other segments, material exit is expected among non-bank lenders, some bricks and mortar lenders and home credit lenders, secondary credit brokers, debt management firms and firms carrying out related activities. This exit, however, is expected to be associated with the provision and distribution of credit by firms for which credit is a marginal part of their business. For this reason, Europe Economics expect that in most segments the supply of consumer credit should overall only be slightly affected. In relation to insolvency practitioners, a specific exemption has been introduced for these firms which will should mitigate detrimental effects on these.<sup>2</sup>

<sup>2</sup> See Chapter 3 for further details.

- 22. Aspects of the appointed representative regime will hamper competition.** Several responses touched on this issue. For example, two respondents pointed to how the prohibition on firms with interim permission acting as principal to an appointed representative would limit availability of principals and hamper firms' ability to plan whether they can stay in the market once their interim status expires. One respondent cited a belief among some motor dealers that principals will be unwilling to take on the responsibilities of the FCA regime compared to the perceived benign OFT regime. This also would lead to limited supply of principals and so greater costs through higher fees or higher costs from dealers having to be directly authorised. Another respondent pointed to the restriction that limits a debt collection business to one principal, arguing that this would reduce competition and that increased costs as a result will be passed on to consumers.

#### Our response

We have made changes in response to the feedback to the CP, including that debt collection businesses will be able to enter into multi-principal arrangements. This will help to reduce the potential adverse effects the appointed representative regime could have had on competition in the debt collection market. On concerns that there will be a limited supply of principals, this is a question for firms to decide (i.e. whether they will choose to be principals and for which firms) and difficult to predict at this stage, Europe Economics acknowledge in their revised CBA that appetite is limited and some firms will need to apply for a limited permission or full authorisation. Also, for firms with interim permission considering becoming appointed representatives post-interim regime, the uncertainty will diminish as more fully authorised firms become principals and begin to offer services, and their ability to plan should improve. More generally, some of the uncertainty expressed here also relates to the issue that impacts generally depend, as acknowledged in the CBA, on firms' perception of the FCA. We will be continuing work to engage with firms to clarify what they can expect under the new regime.

**Competition in certain consumer credit markets is currently ineffective.** Some respondents identified problems with competition in consumer credit. For example, two responses argued that competition was ineffective in particular markets at preventing firm practices which were exploiting consumers' behavioural biases in areas such as product design and marketing. Another respondent argued that in payday lending, more intensive competition had been associated with irresponsible lending and consumer harm. Another respondent emphasised the importance of not simply judging the health of competition by number of firms or by supply of credit, arguing that in some cases a reduction in the supply of credit could be beneficial to consumers.

#### Our response:

The overall impact of the proposals and certain aspects of them should help improve firms' levels of compliance with regulatory requirements and may strengthen competition by making it more likely that firms compete on features that are of value to consumers. Also, specific proposals on transparency (e.g. complaints data publishing) should help consumers to make more informed choices.

We have also developed our proposals in line with our competition duty, which requires us, as long as it is compatible with acting in a way which advances our consumer protection objective or our market integrity objective, to discharge our general functions in a way which promotes effective competition in the interests of consumers.

In addition, in our forthcoming work on consumer credit markets, we will consider how competition is functioning and how consumer behaviours may be affecting how firms compete. This will also inform our publication on the FCA's view of key risks in these markets.

### Transition: the interim permission regime

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

23. Responses were broadly in favour of the concept of the interim permission regime, acknowledging (in the majority of cases) that this was the most proportionate method of phasing in the transfer. There were, however, a range of concerns and other issues raised by respondents in response to this question.
24. A common concern was the demanding timetable and the level of resource needed to complete the move through interim permission to full authorisation (one respondent added that the timetable meant that an interim permission stage was 'essential').
25. A small number of respondents, mainly large firms, suggested that a better regime would be one under which firms which are already regulated by the PRA or FCA were 'grandfathered' into authorisation. This is because the PRA and FCA were already familiar with these firms.
26. Many firms were critical of the proposed status disclosure rules in the interim period, noting both the cost and logistical challenge of changing materials several times, and arguing that these status disclosures either had no impact on consumers or were potentially confusing, with the risk of causing consumers to make poor decisions.<sup>3</sup>
27. Although a few respondents were supportive of the proposal that only fully authorised firms would be able to have appointed representatives, a number were concerned with the impact on current business models, and (as a consequence) on competition (given the plan for different sectors to be asked to apply for full authorisation at different times).
28. Some consumer groups expressed concern about the approach to be taken to supervising firms in the interim period. CP 13/7 indicated that this would be 'events-driven' and 'issues-based', and several respondents queried whether this risked the continuation (or increase) of poor customer treatment, with some suggesting that it undermined the case for the transfer to the FCA (given that the tougher supervision by the FCA is a core driver of the improved customer outcomes the transfer should achieve).

<sup>3</sup> See Part B - Policy Statement on the high-level rules we consulted on in CP 13/7.

29. Concerns were also expressed about the notifications or actions which would require an application for full authorisation. A range of respondents queried the impact on firms being able to enter new markets or offer new services if they would need to wait until they obtained full authorisation. Other respondents asked for clarity on whether they would need to apply for full authorisation in the event that they wished to amend their trading names, or notify the FCA of changes to their directors or controllers.
30. Some firms suggested that it would be helpful to allow corporate groups including multiple licensed entities to use a consolidated interim permission process.

### Our response

The Government has set out the interim permission regime as proposed. But we have accepted that the proposals for disclosure of a firm's interim permission status were unnecessary.

We have been persuaded by the arguments regarding the general disclosures in the interim permission period and have amended the rules we have now made accordingly. A firm with an interim permission will not be required to disclose this explicitly (see Chapter 2).

It was apparent from the responses to the consultation that more clarity and assurance is needed on a number of points.

- We appreciate that the timetable is very challenging. We are building up our resources to deal with this – we will be joined by a number of colleagues from the OFT and are recruiting additional staff to ensure that we can deliver the required support.
- Paragraphs 3.22-3.25 of CP 13/7 (on supervision in the interim permission period) were not intended to imply that our supervision would be passive in any way. As we learn more about the market, our immediate priorities will be in responding to known and emerging issues. It is crucial that the more rigorous scrutiny the FCA is able to bring to bear is deployed effectively as soon as possible in this market in order to realise the benefits of the transfer from the OFT. Our approach to supervision in the interim period is covered in our response to Question 21.
- Changes to directors or trading names will not trigger an application for full authorisation. Changes to firms' directors will be assessed as part of the approved persons scrutiny at the time of application for full authorisation.
- We remain of the view that it is essential that firms wishing to use appointed representatives need to be fully authorised, as they will be responsible for the activities of their appointed representatives and need to have had their business models and controllers properly reviewed. However, having noted the concern, we plan to call firms that have responded when submitting their interim permission notification that they wish to act as principals to apply early in the authorisation process. We also note (and this is also relevant to concerns about having to delay new business development, and firms in large groups) that firms are not required to wait to submit their applications until they are called.

## Authorisation

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### **Q5: Do you agree that we should apply the threshold conditions as proposed?**

- 31.** The majority of respondents supported the proposed application of the threshold conditions, with certain respondents expressing strong support for the importance of threshold conditions in terms of the 'gateway' into the sector.
- 32.** Some respondents raised questions around three aspects of the proposals:
- More detail was requested on what the application process would entail in practice, with particular reference to the materials needed to support an application for authorisation. Some respondents commented that it was difficult to assess the proportionality of the proposals in the absence of such detail;
  - Some respondents challenged whether the threshold conditions were disproportionate in the requirements they imposed on small businesses; and
  - Some concerns were raised about overseas firms:
    - The implications of certain EEA firms being able to trade in the UK without being authorised by the PRA or FCA. It was suggested that this would create a potential gap in consumer protection, undermining the rationale for the transfer to the FCA itself. One respondent specifically suggested that consumers should be warned about this and told to be vigilant;
    - The FCA needs to be particularly vigilant regarding non-EEA firms who attempt (or claim) to structure their business models in such a way as to fall outside the scope of UK law and regulation entirely (essentially by claiming not to lend into the UK); and
    - The interplay between overseas firms and the threshold conditions, and specifically the requirement to have 'mind and management' in the UK, was challenged by a trade association, because of the logistical and financial impact on firms which currently would not be seen as satisfying this condition. One consequence of this, it was suggested, would be market exit of these firms.
- 33.** In addition, some respondents questioned the rationale behind the Government's approach to limited permission, including with respect to:
- the activities which were categorised as being lower risk; and
  - whether certain not-for-profit bodies should be able to rely on a limited permission while profit-seeking providers of the equivalent services were required to be fully authorised (this issue is discussed further in Chapter 2).

### Our response

We propose to proceed with our proposals as set out in FSA CP13/7.

In order to understand the detail needed to support applications, firms should refer to the current application packs for existing FCA regulated firms for an indication of the types and granularity of the information required. The current packs for home finance providers and insurance intermediaries are likely to be the most helpful.

Firms should note that the information which is expected to be provided should be proportionate to the nature and scale of the regulated activities undertaken. This arises from two aspects of the regime; i) firms seeking limited permissions will be subject to modified threshold conditions; and ii) certain activities (including those carried out by firms seeking full authorisation) will naturally require less detailed information to satisfy us as to the firms' compliance with the threshold conditions.

In addition, we expect to produce and publish on our website draft authorisation packs shortly prior to 1 April 2014, to allow firms to assess the preparation needed.

We remain strongly of the view that 'mind and management' being located in the UK is essential in order for us to supervise firms that we authorise properly.

The approach outlined in FSA CP13/7 on overseas firms reflects the current position on overseas firms' ability to offer regulated financial services to UK consumers and we do not propose to make any changes. Non-EEA firms and EEA firms not satisfying the criteria to trade without authorisation from the PRA or FCA will be required to apply for authorisation, in order to maintain consumer protection and a level playing field for firms. In line with our current approach to other activities we regulate, we will be vigilant in guarding against unauthorised trading.

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

- 34.** The majority of respondents generally supported our proposals and considered them to be both appropriate and proportionate.
- 35.** The issue that attracted the most polarised views was our proposed differentiated approach to applying approved persons requirements to profit-seeking and not-for-profit providers of debt advice.
- 36.** A number of respondents (in particular – but not exclusively – respondents on behalf of the profit-seeking debt management and debt collection sectors) considered that not-for-profit providers of debt advice should be subject to the same approved persons requirements as profit-seeking debt management firms, in particular, having an approved person responsible for client asset operational oversight.

37. Some respondents indicated that although the proposals seemed appropriate and proportionate in principle, it was important that the FCA ensured that the application of its approved persons requirements in practice was also proportionate.
38. This was particularly important with regards to their application to:
- Small and medium-sized enterprises (SMEs); and
  - Firms for whom their credit activities were only secondary to their principal business activity (since such firms may not employ any 'credit experts' as such).

### Our response

We propose to proceed with the majority of our proposals in FSA CP13/7 – but subject to some changes. However, as stated in chapter 3, our approach to applying approved persons requirements to banks may be subject to some change as our thinking develops on the recommendation by the Parliamentary Commission on Banking Standards that a new Senior Persons Regime and licensing regime should replace the approved persons regime in respect of deposit-taking institutions.

We do not propose to apply all the same controlled functions to not-for-profit bodies that provide debt advice as will be applied to profit-seeking debt management firms. This is because we do not wish to constrain the provision of 'free to the customer' debt advice by imposing undue costs and burdens on not-for-profit firms providing such advice.

However, we are persuaded that there is a strong case for applying client assets operational oversight requirements to not-for-profit providers of debt advice that, at any point in the previous year held, or propose to hold in the forthcoming year, an amount of client money equal to or greater than £1 million. Consequently, we propose that such firms should be required to have a person approved for the carrying on of the client asset operational oversight function. The not-for-profit bodies that we are aware of, to whom this requirement would currently apply, understand and support this proposal.

We have also revised our proposed approach to applying the client asset oversight function to profit-seeking debt management firms. Consistent with our current approach to investment firms (and not-for-profit bodies as described above), this function would be applicable to a director or senior manager in 'large debt management firms' holding an amount of client money equal to or greater than £1million, but not to all debt management firms as proposed in FSA CP13/7. However, small debt management firms (holding less than £1 million) would still be required to appoint an individual to be responsible for overseeing the firm's client assets operations. This individual would have to be already approved for another significant influence function.

With regards to the potential impact of our proposals on SMEs, we are proposing limited, or no, application of some controlled functions to sole traders. Where we are proposing to apply controlled functions to such firms, it is to the extent that we consider it necessary to do so in order to provide the appropriate level of consumer protection – for example, applying the compliance oversight function to

sole trader profit-seeking debt management firms with employees involved in the carrying on of the regulated activities. We have made some slight amendments (some only clarificatory) to our proposed application of approved persons requirements compared to the position set out in FSA CP 13/7. For example, the money laundering reporting officer function and the compliance oversight function would not apply to sole traders with no employees. Similarly, the apportionment & oversight function would not be applied to sole traders if they do not employ people who have to be approved persons and the systems and controls functions and significant management functions might only apply to sole traders in limited circumstances in which they have a substantial number of employees.

Contrary to our proposal in FSA CP 13/7, we are proposing that authorised firms whose principal business activity is not a regulated credit activity – other than firms with limited permissions and some authorised professional firms in respect of their non-mainstream regulated credit activity – would be required to have responsible people pre-approved to undertake significant influence functions including the governing functions. This is consistent with current thinking that senior individuals in firms should generally be assigned and held accountable for the most important responsibilities.

As indicated in Table 4.2 in FSA CP 13/7, we consider that most authorised firms whose principal business activity is not a regulated credit activity are likely to be carrying on lower risk credit activities and will have limited permissions (for example, retailers who broker credit for their customers so that they can purchase their goods or services on credit terms). We are proposing that such firms would still only be required to have one person approved for the apportionment & oversight function in respect of the credit activity to which the limited permission applies. Similarly, we are proposing that if authorised professional firms are carrying on non-mainstream credit activities on an incidental basis, then only the required functions would apply to them. This is likely to mean that, for many, the only applicable controlled function will be the apportionment & oversight function.<sup>4</sup>

Where firms are carrying on higher risk credit activities – even if this is not their principal business activity – we consider that they should, in most instances, have senior individuals pre-approved and accountable for the undertaking of significant influence functions within the firm including the governing functions. This could apply to, for example, authorised debt management firms whose principal business activity is claims management.

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

- 39.** While respondents' views were split, the majority considered our proposal to be proportionate.
- 40.** Some consumer groups, in particular, considered that advisers in profit-seeking debt management firms should be subject to a customer function. However, a number of respondents considered that if profit-seeking debt management firms' advisers had to be approved, then so should the advisers of not-for-profit debt advice bodies – contending that just because no fee is charged

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<sup>4</sup> see SUP 10A.1.17R

for the provision of debt advice does not mean that the provider is necessarily 'competent'.

41. A couple of respondents suggested that it was important to clarify that a customer function could be applied to second charge lenders and brokers depending on the outcome of the European Mortgage Directive deliberations and how this impacts on their regulation.

### Our response

We do not propose to apply the customer function to any credit activities at this time.

We consider that applying the compliance oversight function to profit-seeking debt management firms is a proportionate approach to addressing issues of non-compliance that have been identified (primarily by the OFT compliance review of its Debt Management Guidance) in the sector. A decision about whether the customer function should apply to second charge firms will be taken when we consult on the longer term regime, once the European Directive on Mortgage Credit has been finalised.

### Alternatives to authorisation

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

42. The majority of respondents were broadly supportive of our proposals, considering them to be largely reasonable and proportionate. However, some respondents did not support aspects of the proposals. Views included:
- all firms should be directly regulated by the FCA;
  - an appointed representatives regime was not appropriate for the credit sector; and
  - the option of being an appointed representative should not be extended to, in particular, firms carrying on 'high risk' credit activities such as profit-seeking debt management firms.
43. Some specific concerns were raised about the suitability of the appointed representatives option for motor dealerships, with a couple of respondents suggesting that lenders would be reluctant to take on the responsibility of being principals to motor dealerships wishing to be their appointed representatives.
44. Representatives of the debt collection sector expressed concerns about the proposal that the option of being able to enter into multi-principal arrangements would not be available to firms carrying on debt collection. They argued that such a restriction would have an adverse impact on the operation of the sector and could lead to 'field collectors', who recover debt repayments on behalf of a number of different debt collection firms, leaving the sector.
45. They further suggested that allowing field collectors to act on behalf of a number of principals (authorised debt collection firms) can be advantageous in particular for debtors who owe multiple debts to different creditors, since they may need to only deal with a single field collector

in respect of all/many of their debts rather than having to deal with numerous different debt collection firms each pursuing debtors for different debts.

### Our response

The Government has decided that the option of being an appointed representative should be made widely available to firms carrying on credit activities.

Existing FCA requirements mean that firms will only be permitted to be principals if they:

- satisfy the FCA that they are fit and proper persons;
- have appropriate systems and controls in place to effectively regulate the conduct of their appointed representatives;
- comply with the FCA's supervisory requirements for appointed representatives;
- ensure that their appointed representatives adhere to the terms of their contract with their principal; and
- meet the FCA's requirement to notify it of the appointment of appointed representatives.

The Government has decided that, given their central role in helping to inform responsible lending decisions, credit reference agencies should be directly regulated by the FCA. It has decided to extend the option of being an appointed representative to lenders which provide credit free of interest and without any other charges (such credit provision is not covered by the Consumer Credit Directive). It is not at this time extending the option of being an appointed representative to peer-to-peer lending platforms carrying on the new regulated activity of 'operating an electronic system in relation to lending'.

Being an appointed representative is not the only lower cost option available to firms carrying on credit brokerage as a secondary business activity (for example, some motor dealerships or other retailers). They can, alternatively, apply to be authorised with a limited permission as long as they do not also carry on a regulated activity (other than one in relation to which they are an appointed representative) that falls outside of the limited permission regime.

Having considered representations made during the consultation, we are now minded to allow appointed representatives carrying on debt collection to enter into multi-principal arrangements. We are persuaded that there is a significant risk that not to do so could potentially have an adverse impact on the operation of the sector in a way that could harm the interests of those being pursued for multiple debts in particular. However, we would expect all principal firms, in line with our Principles for Businesses, to ensure that their appointed representatives are fully transparent about which debt collection firm(s) and/or creditor(s) they are acting on behalf of in respect of specific debts (Principle 7) and to exercise appropriate forbearance when borrowers are experiencing repayment difficulties (Principle 6). If we were to find evidence that this was not happening,

the principal firm(s) concerned would be at risk of enforcement action and we may reconsider our rules.

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

- 46.** The majority of respondents supported our proposal, although some of the support was qualified. Views included:
- it was important to ensure that principal firms (home collected credit providers) take appropriate responsibility for the conduct of their agents;
  - lending to potentially vulnerable consumers by firms in the home collected credit sector was a high risk activity and agents should be required to be directly authorised by the FCA;
  - self-employed agents carrying on credit activities in sectors other than the home collected credit sector should not need to be authorised or exempt if they meet our criteria for being an agent;
  - being paid a commission for introducing new customers to the principal should not exclude a person from meeting our criteria for being an agent; and
  - amendments should be made to the Government's proposed exemption for mail order agents to better reflect current industry practice.

### Our response

We are consulting on draft Perimeter Guidance which sets out our proposed criteria for being an agent.<sup>5</sup> Self-employed agents of home collected credit firms meeting our specified criteria are likely to be regarded as carrying on the business of the principal firm they are representing and will not need to be authorised or appointed representatives of the principal firm.

Principal firms will be held fully responsible for the conduct of any agents contracted to carry on their business on their behalf and enforcement action could be taken against the principal in the case of misconduct by an agent. The principal's own fitness to be FCA authorised may be called into question if its agents do not comply with rules that apply to the principal firm.

Furthermore, unless principals and their agents meet our criteria for an agent to be considered to be carrying on the business of the principal, the 'agents' are likely to need to be authorised or appointed representatives of the principal firm. If a person carries on regulated credit activity as his own business, rather than as an 'agent' carrying on his principal's business (for example, it carries on regulated credit activities on behalf of more than one principal) and without being authorised or exempt (by virtue of being an appointed representative), it may be committing a criminal offence.

<sup>5</sup> See Appendix 2.

If persons carrying on regulated credit activities in sectors other than the home collected credit sector meet our criteria for being an agent, they will not be required to be authorised or to be an appointed representative of a principal. In case of doubt, a person should seek their own legal advice (some trade associations might be able to provide assistance in this regard).

Having considered the representations made during the consultation period, we are now of the view that being paid commission for introducing new customers to the principal should not necessarily preclude a person from meeting our criteria for being considered to be an agent. While we consider that where the introducing of new customers to the principal firm for a fee or commission represents more than a limited element of a person's business/remuneration, he is more likely to be carrying on business on his own behalf than carrying on his principal's business, we do not consider this to be a particularly strong factor as many conventional employees are paid by commission. So we are not proposing to include this amongst our specified criteria.

Although the overall relationship between a home collected credit provider (the principal) and its agent will need to be taken into account, we propose that meeting our specified criteria is likely to mean that the agent does not require authorisation on the grounds that he is carrying on the business of the credit provider and not his own.

The Government has amended the exemption for mail order agents (Article 36B of the Regulatory Activities Order) to better take account of current industry practice. The amendments allow for the financing of the credit agreement to be done by a finance arm in the same corporate group as the mail order firm (rather than necessarily by the mail order firm itself) and for visits to customers and potential customers by agents of mail order firms to be 'solicited' as well as unsolicited.

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

- 47.** The majority of responses agreed with the Government's proposals. However, some respondents sought more clarity on how the Part 20 regime would operate in practice, including, in particular, how we would apply the 'incidental test' and the DPB rules approval process. They stated that early clarity on these issues was needed to enable relevant stakeholders to engage with the FCA on these issues sufficiently far in advance of 1 April 2014.
- 48.** Professional bodies recognised the challenges the change would bring in registering/authorising firms, creating appropriate rules governing their activities, and recouping the costs incurred. One professional body argued that there was a significant risk that the process could not be completed by 1 April 2014.
- 49.** Alternative suggestions included exempting entirely professional firms only carrying on lower risk credit activities, or extending the FCA's 'grandfathering' approach that it is applying to not-for-profit bodies providing debt advice, to professional firms.

### Our response

The Government is allowing members of DPBs to undertake consumer credit activities under the FSMA Part 20 regime if they satisfy the relevant conditions.

The FCA is currently working with the DPBs with a view to establishing suitable regime arrangements from 1 April 2014, including deciding whether to approve rules proposed by the DPBs governing the consumer credit activities of their members, and ensuring that members are aware of and prepared for the changes. As part of this work we would not object if a DPB were to extend to EPFs, the same 6-month transitional period that we are proposing is available to authorised firms<sup>6</sup>, whereby if the EPF is able to demonstrate that it has acted in accordance with previous equivalent CCA requirements and OFT guidance, the DPB will not take action against it in relation to new DPB rules that are substantially the same.

## Prudential standards for debt management firms

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

- 50.** Respondents were generally supportive of our proposals to apply prudential standards to debt management firms. Some respondents agreed with prudential standards in principle, but wanted to widen the scope of the requirements to other consumer credit firms that held client assets (for example, debt collectors and not-for-profit debt advice bodies).
- 51.** Other comments that we received on our proposals included:
- prudential requirements should be introduced as soon as consumer credit is transferred to the FCA (i.e. 1 April 2014) as opposed to when firms become fully authorised.<sup>7</sup>
  - the fixed minimum prudential requirement of £5,000 is too low.

### Our response

As a result of this feedback, we are proposing to extend our prudential standards to include not-for-profit debt advice bodies that, in the last 12 months have held £1m or more in client money or, as the case may be, that have projects in place that mean they will hold £1m or more in client money over the next 12 months. We believe that this is in line with our prudential philosophy to focus on entities that pose greater risks to consumers. As a result of including these firms, there will be several advantages for consumers, including:

- if a firm were to fail, these financial resources will aid an orderly wind-down;

<sup>6</sup> April 2014 to end September 2014, as discussed in Chapter 2 of CP 13/7 under 'smoothing the transition'.

<sup>7</sup> This is only applicable to existing OFT-regulated debt management firms that decide to register with the FCA by 31 March 2014 and, therefore have an interim permission. Those firms who do not have licences will have to become fully authorised and will therefore be subject to our full prudential requirements (but with certain transitionals about what can count as capital) from the point they are authorised.

- 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.

Although we accept that these firms pose a risk to the market now, we do not believe that it would be appropriate to introduce our requirements immediately. This may unfairly impact existing OFT only regulated firms who could find it difficult to raise the required prudential resources by 1 April 2014. Consequently, if our proposals were introduced immediately they could inadvertently reduce competition in the market. Therefore we continue to propose that existing OFT only regulated debt management firms that move into the FCA's interim permission regime will not have to meet our prudential standards until they become FCA-authorized firms.

We believe that a fixed minimum of £5,000 is an appropriate amount. Although we want to ensure appropriate consumer protection, we do not want to create a barrier to entry for new firms. Furthermore, the prudential requirement proposal is the higher of a fixed minimum and a variable requirement. As a firm becomes established in the market its prudential requirement is very likely to be based on the variable element.

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**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)?***

52. Respondents did not envisage any difficulties in providing data on the size of debt contracts being negotiated and/or the amount of client money being held.

**Our response**

With respondents confirming they would be able to provide data on the above metrics, we are confident that our volume-based measure (relevant debts under management) is a viable option for firms when calculating their prudential requirement.

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**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?***

53. We received a range of potential measures from respondents. These included:
- the amount of time that debt management firms retain client funds before dispersing payments to creditors;
  - the percentage of the total indebtedness of their clients at any time; and
  - the average length of time a firm's clients are on a debt management plan.

### Our response

We looked into these measures as possible options for our prudential regime. We believe that the suggestions:

- would be difficult to formulate into workable prudential policy proposals without making the prudential requirements metric overly complex for firms to calculate;
- would not sufficiently reflect the prudential risks that debt management firms pose to consumers; and
- would be difficult for us to monitor.

Our proposals are set out in Chapter 7 and the draft handbook rules are in CONC 10.

### Conduct standards

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

- 54.** The majority of responses agreed with our proposed approach to financial promotions, but considered that they needed to see the detailed rules before commenting fully. However, some consumer groups argued that more and stricter controls are needed for financial promotions.
- 55.** A small number of respondents disagreed with the FCA's proposals and argued that consumer credit is different from other financial services and that advertising is already well regulated. Several responses emphasised the maximum harmonising nature of the CCD which limits form and content and underlined that the current CCA regime reflects this.
- 56.** There were a small number of responses which argued that the advertising rules for mortgages and consumer credit should be simplified into one set of rules, while another highlighted the potential double change for second charge lenders and brokers to the consumer credit interim regime and then to the longer term regime for second charge (which will have to meet Mortgage Credit Directive requirements).
- 57.** Several respondents felt that the current level of protection against cold-calling and unsolicited marketing activities is too weak. While others were concerned about the omission of credit information and credit reference services from the new regime.
- 58.** Several respondents believe that the transitional period should be at least 12 months, as catalogues have a long lead-in time before publication, which could result in them being non-compliant on 1 April 2014.

## Our response

We are proposing to create rules for financial promotions that reflect the current CCA advertisement standards in our financial promotion chapter (see CONC 3.5)

The key provision of the financial promotion chapter is the clear fair and not misleading rule which we propose to apply to lenders, brokers, P2P platforms, debt counsellors and debt adjusters and to consumer hiring (see CONC 3.1).

We also propose to include a rule requiring non written communications to be done only at an appropriate time of day and to identify the person making it, the firm represented and the purpose at the outset. We propose that firms should not approve financial promotions to be made in the course of a personal visit, telephone conversation or other interactive dialogue. The effect will be to prevent non-authorised firms from engaging in these activities.

In some cases, we propose to clarify provisions reflecting existing requirements. For example, we clarify that statements about the speed at which a loan can be obtained are an incentive for the purpose of the rule requiring a Representative APR (or a typical APR for an agreement secured on land) to be stated in a financial promotion.

Although we are not able to apply the financial promotions regime to credit information and credit reference services, we do propose to apply the clear fair and not misleading rule (CONC 3.3.1R) to communications by a firm providing credit information services. In addition we have already consulted on the Principles applying generally to credit firms and hence Principle 7 would apply in this case. Similarly, the financial promotions regime will not apply to not-for-profit debt advice bodies, but Principle 7 will apply.

As HMT have included an exemption for promotions aimed solely at lending for the purposes of business, consistent with the position under the consumer credit advertisement regulation, we are consulting on detailed rules for financial promotions aimed at consumers and not extending them to activities aimed solely at business.

In order to smooth the transition of second charge firms into the consumer credit regime and to the longer term second charge regime, we are proposing that where adverts relating to second charge lending are currently subject to the CCA rules<sup>8</sup>, these adverts will remain subject to similar standards in the new FCA consumer credit regime until the longer term mortgage regime commences (see CONC 3.6). We propose that the consumer credit financial promotion rules will not apply to the extent a promotion is for qualifying credit. Given that the financial promotions rules will largely reflect current requirements, we propose that rules which correspond to current provisions should be subject to the same transitional period as other conduct of business requirements, that is to say the FCA would not take enforcement action based on a new rule where the firm in question can show that it is complying with the corresponding CCA requirement or OFT guidance (see CONC TP1).

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<sup>8</sup> CCARs 2004

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

- 59.** We received a number of comments from respondents in relation to industry codes. Broadly, responses to this question fell into four groups:
- A small number of respondents rejected the incorporation of any industry code provisions at all.
  - At the other extreme, a small group of respondents strongly argued that consumer protection demanded that ‘self-regulation’ be brought to an end, and all codes be incorporated into FCA rules or guidance.
  - Some respondents stated that they did not object in principle to the concept of certain code provisions being incorporated into rules or guidance, but said that it was up to the FCA to identify appropriate candidates for inclusion, and that they would need to consider such proposals in detail.
  - The remainder agreed that codes added (or could add) value, but recognised that consumer protection arguably demanded that particular provisions be incorporated into the Handbook. These respondents tended also to identify particular provisions for us to consider incorporating. Some of the arguments of these respondents, when discussing specific codes or sectors, overlapped with those in the second group above, and criticised what they regarded as ineffective or poorly-observed codes.
- 60.** The third and fourth groups identified above agreed with our analysis as to the potential benefits of industry codes. Codes can allow firms (often acting in conjunction with Government, consumer groups and regulators) to respond quickly and flexibly to developments. They can add real value when they disseminate and develop best practice.<sup>9</sup>

### Our response

We have decided to adopt a case by case rather than a blanket approach. We are persuaded both that some of the code provisions offer important protection to consumers which merit incorporation into our regime, but also that codes can play a useful role. We are also mindful that adopting too many important code provisions could undermine code sponsors’ rationale in maintaining and overseeing a code – with the result that the value added by codes could be lost.

Subject to constraints imposed by EU law, our approach has therefore been to examine the key industry codes. Where our view is that a particular provision advances our consumer protection objective and can be supervised and, we are consulting on its incorporation in the Handbook.

<sup>9</sup> We agree in principle that codes which consist predominantly of restatements of existing legal and regulatory requirements are of limited value; although we acknowledge that they can act as a cost-effective starting point for new entrants to assess the regulatory regime when considering new products.

### Conduct standards: specific activities

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

- 61.** While our proposals attracted a range of views, there was widespread support for the principles that underpinned our proposals:
- it is appropriate to apply different conduct standards to different types of debt advice provision depending on the associated risk (a view held by respondents who represented lenders in particular); and
  - not-for-profit providers of debt advice should be subject to the same conduct rules as profit-seeking debt management firms.
- 62.** However, some concerns were expressed – particularly by representatives of consumer advice organisations – regarding the clarity of the boundaries between the proposed different types of debt advice provision. Views included:
- debt advisers would not reasonably be able to draw a distinction between the proposed two different types of regulated debt advice referred to in FSA CP13/7<sup>10</sup> - and it would not be appropriate for them to have to do so;
  - the proposed distinction between the two types of regulated debt advice is artificial and does not exist in practice;
  - it was not clear whether general ‘budgeting advice’ and ‘money advice’ would be classified as generic advice or regulated debt advice;
  - while a provider of debt advice might not initially identify a debt solution for a borrower to enter into, he may subsequently do so. Debt advice providers cannot be expected to ‘check themselves’ during the course of advising a borrower on his debts in order to prevent them straying from providing lower level regulated debt advice, to which limited conduct rules apply, into the provision of higher level advice which recommends a particular debt solution to a borrower, to which more comprehensive FCA rules apply; and
  - the unintended effect of differentiating between two different types of regulated debt advice to which different FCA rules apply could be to discourage some debt advice providers from providing holistic/comprehensive debt advice to those who require it.

<sup>10</sup> a) Advice on the liquidation of a consumer credit debt which is specific to the borrower but the advice provider does not identify a particular debt solution for the borrower to enter into and b) advice on the liquidation of a consumer credit debt where the advice provider does identify a particular debt solution for the borrower to enter into.

## Our response

We find the views expressed by representatives of some of the consumer groups persuasive and we propose to adopt a revised policy approach whereby we limit the differentiation between different types of debt advice provision to two classifications:

- generic advice which is not regulated debt counselling; and
- regulated advice on the liquidation of a debt due under a consumer credit agreement (or a consumer hire agreement).

As is the situation under the current regulatory regime, all regulated debt advice provision will be subject to conduct of business rules. They will be largely derived from the OFT's Debt Management Guidance, carried across into FCA rules or guidance as appropriate – although we are also proposing to incorporate some rules derived from voluntary codes.

However, with a view to maintaining a proportionate approach to regulating those that provide different types of regulated debt advice, in applying our rules, we will take account of the nature, scale and complexity of the firms' debt advice activities. So, for example, we will not expect a firm to demonstrate it has systems in place to ensure compliance with our rules relating to the administration of debt management plans if it does not provide debt solutions.

The draft rules that we propose to apply to providers of regulated debt advice are set out in Appendix 2 as is our draft Perimeter Guidance on what constitutes regulated debt counselling.

In general terms, we consider that the provision of budgetary or money advice is unlikely to constitute regulated debt counselling - if the process of providing such advice is limited to assisting the indebted borrower to make his own choice as to a course of action he might take with regards to seeking to free himself from his obligations to his creditors in respect of consumer credit related debts. On the other hand, if the advice provider voices 'opinions' or makes 'recommendations' to a borrower as to a course of action he could/should take to liquidate his consumer credit related debts (for example, recommending that he enters into a debt management plan), then he is likely to be providing regulated debt advice.

Although the provision of generic advice regarding debts would not constitute regulated debt counselling, if it is provided in connection with (and ancillary to) the carrying on of a regulated activity, then the provision of such advice will be subject to the FCA's Principles for Businesses – for example, Principle 7, which states that communications to clients must be clear, fair and not misleading. This will be the case in respect of, for example, any generic advice on debt provided by a person in connection with his carrying on of credit brokerage.

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

- 63.** The majority of the respondents supported the proposed requirements with some commenting that they were reasonable, proportionate, and important for the protection of consumers.
- 64.** Some respondents also commented that well run firms should not struggle to comply with these requirements and expressed the view that a stronger client assets regime was required for debt management firms because standards set out in current OFT guidance were not sufficient and had not been enforced robustly enough.
- 65.** Many respondents expressed the view that the proposed requirements should also apply to not-for-profit debt advice providers, with one consumer body commenting that this should not be overly burdensome to them if they are already compliant with existing OFT requirements.
- 66.** A large number of these respondents also considered that the proposed requirements should apply to smaller debt management companies. Reasons for this include:
- applying additional rules to the larger firms only will leave some consumers in a vulnerable position;
  - larger firms may be tempted to split up into small firms to avoid being effected by the proposed requirements;
  - the greatest risk of misuse of client money exists more in smaller, recently established businesses;
  - typically, large organisations are more likely to have greater governance structures than small firms, so whilst a lesser number of consumers might be impacted, the likelihood of detriment resulting could be greater;
  - larger firms are more likely to be subject to regular external audits and have more oversight over their client accounts; and
  - the size of a debt management firm is not necessarily a good guide to how well-run that firm is. Consideration should also be given to such matters as a firm's supervisory risk category
- 67.** Other respondents suggested the following:
- the client assets regime should also apply to debt collection firms in respect of the money they collect from debtors on behalf of creditors;
  - the client assets regime should also apply to firms that hold a client's physical personal possessions as a security such as money shops, pawn-brokers, logbook loan and guarantor loan providers; and
  - bonded accounts (currently used by insolvency practitioners supervising IVAs) could be a possible alternative to the proposed client assets requirements.

## Our response

Given that among the large range of responses there was in general support for our proposals, we are largely taking forward the proposals outlined in CP13/7. However, taking into account some comments, we have made some changes to our original proposals.

### **Not-for-profit providers of debt advice**

Some respondents commented that if not-for-profit debt advice providers are holding client money, that money should be subject to the same protections as money held by profit-seeking firms. We tend to agree and so we now propose to apply our rules to not-for-profit debt advisers that hold client money. Like debt management firms not-for-profit debt advice bodies are already subject to OFT guidance so we do not consider our proposed requirements would be any more burden to them than they would be to a debt management firm.

In addition to the OFT guidance, we had mentioned further proposals, such as additional record keeping, reconciliations, bank acknowledgement letters, annual independent client money audits, and the proposal that the function of overseeing the firm's treatment of client money should be allocated to an approved person. The protection of client money by debt management firms and not-for-profit debt advice bodies is fundamental to consumers' rights. It is at the heart of ensuring a well-functioning and robust market place and reducing the likeliness of consumer detriment in the event of a firm's failure due to under-segregation and inadequate record-keeping. We consider our proposals are proportionate as they not only strengthen the industry guidance that already exists but also sets a clear standard we expect of firms to ensure that they can sufficiently protect client money in the manner envisaged by Principle 10 of the FCA Principles for Business.

### **Smaller debt management firms**

A number of respondents felt that we should apply all our client assets requirements to firms, regardless of size, on the basis that the same risks arise. We agree that some risks can be similar regardless of size, and so we have proposed to extend several of our proposals originally intended for larger firms only to firms of all sizes. We have not, however, applied all rules to all firms on the basis of proportionality. Our proposals in this CP broadly take forward the approach outlined in CP13/7. We have included draft rules on classification of firms as small or large at Appendix 2.

### **Appointed representatives (ARs)**

Except for insurance mediation business, ARs are not currently permitted to hold client money. We consider this proportionate due to risks like late segregation and poor record keeping. We do permit ARs to hold client money in connection with insurance mediation business subject to certain conditions. This is because their principals are subject to more stringent requirements to double segregate and perform specific reconciliations with ARs. Therefore, we will not be proposing that ARs can hold client money.

### Pawnbrokers, money shops, etc

The Client Assets sourcebook (CASS) currently contains chapters on client money (chapter 7) and client assets (chapter 6). While credit firms may hold various kinds of assets of types not currently captured by CASS 6, we do not currently propose to extend the application of our CASS requirements beyond client money held by profit-seeking firms and not-for-profit bodies which provide debt solutions for clients.

### Debt collection agents

In response to comments that the CASS regime should be applied to debt collection firms that collect (and hold) money recovered from debtors, our understanding is that this money is received by the debt collector in its capacity as agent of the creditor. We regard the money as having been paid by the debtor/received by the creditor at the point at which the debt collector takes possession of it. Consequently, we do not propose to extend client asset requirements to debt collectors.

### Bonded accounts

We have considered the suggestion that the use of bonded accounts could be a possible alternative to the proposed client assets requirements. We consider that the most appropriate way to hold client's money is subject to the statutory trust under which all client money under CASS is held.

The draft rules that we propose to apply to firms providing debt solutions that hold client money are set out in Appendix 2.

**Table A1.1 – Detailed summary of client money requirements for debt management firms and their location within the attached draft instrument**

Proposal and draft instrument or Handbook reference	Large CASS debt management firms	Small CASS debt management firms
<b>Unchanged proposals</b> Included in the March CP and unchanged		
<b>Segregation requirements</b> CASS 11.9	All firms to make arrangements for the prompt payment of client money directly into 'ring-fenced' client money bank accounts, and for the holding of client money in such accounts .	
<b>Payments to creditors</b> CASS 11.10	All firms to ensure payments to creditors are made as soon as reasonably practicable (normally within five business days of receipt) unless a firm: <ul style="list-style-type: none"> <li>• has prior client consent for not doing so</li> <li>• has informed its clients of the risks and implications of a late payment.</li> </ul> Firms to take reasonable steps to ensure clients are not out of pocket in the event of late payment to creditors that was avoidable and not agreed in advance	
<b>Returning money to clients</b> CASS 11.9.12R and CASS 11.9.13G	All firms to return client money promptly and at least within five business days of a written request to withdraw from a debt management plan.	
<b>Organisational requirements</b> CASS 11.5	All firms to have adequate organisational arrangements in place to prevent the use of client money for a firm's own account and minimise the risk of loss due to misuse, fraud, poor administration, inadequate record-keeping or negligence.	

<b>Proposal and draft instrument or Handbook reference</b>	<b>Large CASS debt management firms</b>	<b>Small CASS debt management firms</b>		
<b>Interest</b>	Any interest earned on client bank account should accrue to the benefit of the client not the firm			
<b>Updated proposals</b> – Included in the March CP and subject to some changes				
<b>Client asset oversight responsibility</b> CASS 11.3	Large firms to apportion the Client Assets Oversight controlled function (CF10a) to a director or senior manager within the firm. (See Chapter 3 of the CP).	Small firms to allocate certain client assets oversight responsibilities to a director or senior manager within the firm (Except for a not-for-profit debt advice body, this person should already be approved for another significant influence function).		
All firms to keep a record of this appointment for a minimum of five years if it is not the person performing the compliance function (CF10).				
<b>Statutory trust bank acknowledgement letters</b> CASS 11.6	Firms will receive and hold money as trustee. The client money will be protected by a trust that is created by statute (statutory trust).			
<b>Bank acknowledgement letters</b> CASS 11.8, CASS Annex 1R and CASS Annex 2G	All firms must obtain a letter from each bank they use to deposit client money, in which the bank acknowledges that it will keep the firm's money separate from its clients' and that the bank has no right to use the client money to cover any money a firm might owe to the bank. We have a template letter that a firm can use to request this from bank.			
<b>Client money allocation</b> CASS 11.9.7R to CASS 11.9.9R	All firms must allocate client money receipts to individual clients in their internal records promptly and in any event within 5 business days within of receipt.			
<b>Records of payments to third parties</b> CASS 11.11.3R	A record keeping requirement for all firms to retain records of client money paid to creditors.			
<b>Reconciliations of client money holdings</b> CASS 11.11	High-level requirements for all firms to maintain accurate records of client money holdings, so it is possible to distinguish money held for one client from money held for another, and from a firm's own money.			
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td data-bbox="660 1630 1054 1926">Large firms to perform internal client money calculations / reconciliations and external bank reconciliations. Internal and external bank reconciliations will have to be carried out at least every 5 days, and where a firm carries out daily transactions it should carry out external reconciliations on a daily basis</td> <td data-bbox="1054 1630 1444 1926">Small firms to carry out regular checks of internal records that are reasonable and proportionate to its business</td> </tr> </table>			Large firms to perform internal client money calculations / reconciliations and external bank reconciliations. Internal and external bank reconciliations will have to be carried out at least every 5 days, and where a firm carries out daily transactions it should carry out external reconciliations on a daily basis	Small firms to carry out regular checks of internal records that are reasonable and proportionate to its business
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<b>Proposal and draft instrument or Handbook reference</b>	<b>Large CASS debt management firms</b>	<b>Small CASS debt management firms</b>
<b>Mandates rule</b> Existing CASS chapter 8 <sup>11</sup>	All firms with a mandate (e.g. a direct debit over a client's bank account) giving them the ability to control a client's assets or liabilities to establish and maintain adequate records and controls to prevent misuse (e.g. unauthorised withdrawals from a client's bank account).	
<b>CASS resolution pack</b> CASS 11.12	All firms to maintain an up-to-date document or pack of documents that would point an insolvency practitioner to necessary information to help distribute client money in the event of firm failure. Most of the documents required will usually be part of firm's existing records so not require the creation of any new documentaion.	
<b>Annual independent client money audit</b> Existing SUP chapter 3 <sup>12</sup>	All firms must have an annual audit carried out by an independent external auditor on their compliance with the debt management client money rules and the mandate rules. This audit must also be provided to the FCA within four months following the firm's accounting year end.	
<b>New proposals – Not previously consulted on</b>		
<b>Firm stratification process</b> CASS 11.2	An annual exercise for firms to categorise themselves as either small all large based on their highest holding of client money and to notify the FCA of their firm category. Small firms – hold less than £1million of client money Large firms – hold an amount of client money equal to higher than £1m.	
<b>Selection/review of banks used to hold client money</b> CASS 11.7	All firms owe a duty of care to their clients when deciding where to hold client money.	
	Large firms to consider using more than one bank for the segregation of client money and must consider the appropriateness of their selection of bank. Firms must also keep a record of its decisions for five years after it ceases to hold client money with that bank.	No additional requirements for small firms.
<b>Appointed representatives</b> CASS 11.9.10R	Appointed representatives may handle client money in the form of cash or cheques, as long as they pay them into a firm's client money bank account into within one business day of receiving them. They will not however be permitted to hold client money in their own bank accounts and must instead have processes where any automated payments (e.g. debit card payments) are made by their client directly to a firm's client money bank account.	

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

68. The majority of respondents welcomed the Government's decision to make peer-to-peer lending a regulated activity, with protections for borrowers and lenders (investors) that are individuals or relevant persons. Most of the feedback received regarding the rules that we were considering applying to borrowers was that they appeared to be appropriate and proportionate.

<sup>11</sup> <http://fshandbook.info/FS/html/FCA/CASS/8>

<sup>12</sup> <http://fshandbook.info/FS/html/handbook/SUP/3>

69. However, some respondents suggested that:
- the scope of the regulated activity should be limited to lenders lending to borrowers of the same/similar classification - for example, individuals lending to individuals. It was suggested that the potential risk to the lender is increased where the borrower is a business since it is more difficult to accurately assess the creditworthiness of a business;
  - lending via a peer-to-peer platform should be subject to the same rules as any regulated consumer credit lending;
  - borrowers via peer-to-peer platforms should not be afforded any greater rights/protections than would be the case if they were borrowing from a firm carrying on a lending business; and
  - borrowers should not be entitled to a 14 day right of withdrawal since this would be granting borrowers a 'right' at the expense of lenders.
70. One respondent enquired how firms currently operating peer-to-peer platforms would be able to obtain interim permissions to be able to carry on the new regulated activity from 1 April 2014.

### Our response

The scope of the new regulated activity is a matter for the Government. We propose to proceed to apply rules to peer-to-peer platforms as set out in FSA CP13/7 (see paragraph 10.12), to provide protections for consumer borrowers.

We propose that borrowers should have a 14 day right of withdrawal from agreements entered into with lenders. It is important that borrowers who, upon reflection, consider that taking on a (further) credit commitment may adversely impact upon their financial circumstances should have a period of time in which to withdraw from that commitment. While not having this right could have a material adverse impact on borrowers, the impact on lenders of borrowers exercising a right of withdrawal should be relatively negligible.

In deciding on our approach, we have sought to balance the need to take account of the risks associated with this activity, with the objective of developing a proportionate regulatory regime that will allow this sector to continue to grow and evolve. Our proposed approach is designed to afford borrowers similar rights and protections that they would be entitled to if the agreements that they enter into via the platforms were regulated consumer credit agreements entered into with a firm carrying on a regulated consumer credit lending business.

With this in mind, we additionally propose to apply a requirement for peer-to-peer lending platforms to provide notices to borrowers in arrears or default along with 'information sheets' (corresponding with the equivalent requirement placed on lending businesses under the Consumer Credit Act). The information sheets (in substantially the same form as the existing OFT Information Sheets with only minor changes to reflect the transfer) would provide basic information to borrowers experiencing repayment difficulties and signpost them to sources of free and impartial debt advice.

We also propose to apply equivalent rules to peer-to-peer lending platforms that facilitate borrowers obtaining short-term high-cost credit (payday loans) to those applied to lenders providing such credit. We consider that consumers being offered such loans should be afforded similar protections regardless of whether the loan is offered to them directly by a consumer credit lender or via a peer-to-peer lending platform. Similarly, we propose to require peer-to-peer lending platforms to provide a specific risk-warning to a borrower if the loan is secured against the borrower's home.

Also, relative to the position it consulted on in March, the Government has significantly increased the scope of the regulated activity ('operating an electronic platform in relation to lending') applicable to peer-to-peer platforms. Whereas the scope of the regulated activity consulted on by Government in March only covered the administering of loans made between lenders and borrowers, the scope of the regulated activity in the statutory instrument also covers the following (otherwise stand-alone regulated credit) activities:

- debt collecting; and
- provision of credit information services (including credit repair).

We propose to apply similar rules to peer-to-peer lending platforms carrying on these activities (to the extent that they do carry them on) as to other credit firms carrying on the same activities on a stand-alone basis or alongside other regulated activities. We do not consider this to constitute an additional requirement placed on peer-to-peer platforms. If these activities were not 'embedded' in the new regulated activity, any peer-to-peer platform wishing to carry on these activities would, in any case, need to obtain the relevant permission, and comply with the FCA rules applicable to that activity. It is also the case that if peer-to-peer platforms are already carrying on these activities, they should be adhering to the standards set out in the relevant OFT guidance which will form the basis for our rules (see Appendix 2 for draft rules we are proposing to apply to firms carrying on the regulated activity of operating an electronic system in relation to lending, with a view to protecting borrowers - including the rules that we are proposing to apply to such firms if they are carrying on ancillary credit activities such as debt collection).

Provided that a firm that is carrying on a peer-to-peer lending business has:

- a valid consumer credit licence from the OFT in place at the end of 31 March 2014 which covers the activity of 'debt administration'; and
- it notifies the FCA before 1 April 2014 that it wishes to be granted an interim permission to carry on the new regulated activity of operating an electronic system in relation to lending (and pays the appropriate fee), it should be granted an interim permission.

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

- 71.** The majority of respondents to this question supported the Government's proposal that third parties that trace borrowers who owe debts arising from consumer credit agreements or consumer hire agreements, but do not carry on any other regulated activity (including taking any other steps to collect debts) should be exempt from needing to be FCA-authorized or appointed representatives - but there were some exceptions.
- 72.** While some respondents considered that making the outsourcing firms responsible for the carrying on of the tracing activity was likely to result in them monitoring more closely the conduct of the tracing agents acting on their behalf, some others suggested that monitoring the conduct of firms carrying on the outsourced activity would be difficult and could lead to an increase in misconduct by tracing agents and a consequential reduction in consumer protection.

### Our response

The Government has decided that third-party tracing agents should be exempt from FCA regulation. The draft rules that we are proposing to apply to firms outsourcing the tracing activity are set out in Appendix 2 (see CONC 7.14)

The Government's decision is not intended to 'deregulate' the tracing activity. Indeed, its intention is to strengthen the regulation of the activity by making those that supply the source data, on which third-party tracing agents rely to locate debtors, directly responsible for ensuring that the data supplied is sufficiently accurate and adequate to avoid any subsequent 'mistracing'.

It is already a feature of the current regulatory regime for credit that licensed firms carrying on regulated credit activities are expected to take reasonable responsibility for those that act on their behalf. Indeed, it is a feature of the debt collection sector that many firms outsource the 'collection activity' to field collectors and the outsourcing firms would need to have appropriate systems and controls in place to monitor the carrying on of that outsourced activity in order to be compliant with current regulatory requirements.

## Supervision and reporting

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

- 73.** The feedback received from respondents to our proposals for supervision and reporting was positive. There was broad agreement about all aspects of the supervisory regime and particular support was expressed for a proportionate and risk based approach.
- 74.** There were a number of areas where respondents asked for more detail about aspects of the proposed supervisory regime including how FCA will categorise firms, how the firm systematic framework (FSF) will operate and the factors we would consider when prioritising issues and products supervision. Several respondents from trade bodies and firms already subject to FCA regulation commented that it would be important to ensure consistency in the assigned supervisors of fixed portfolio firms both for credit and other regulated activities. A number of respondents also enquired about the passive/ reactive nature of the proposed regime in

the interim period and that this sounded too 'light touch'. We have included more detailed information about these aspects of supervision in chapter 4 of this CP.

- 75.** In respect of our approach to supervision of financial promotions and Unfair Terms in Consumer Contracts, the responses to FSA CP 13/7 indicated support for a robust approach being taken in these areas. Several respondents asked what this might look like in practice in terms of the action we might take against firms. Again we have set out more detail on our approach to these aspects of supervision in chapter 4 of the CP.

### Our response

We propose to continue with our proposals on supervision and reporting and have provided the requested clarity on our proposals in the supervision and reporting chapter of the CP.

- 76.** As we have stated in our earlier consultation, the majority of firms that we regulate are subject to reporting requirements. The data we use to monitor firms' prudential position and conduct of business is set out in the supervision chapter of the Handbook. We use this information to inform our supervisory activities. We propose that 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 financial and non-financial information. This will enable the FCA to focus its resources on the sectors and issues that are of greatest significance. In chapter 4 of the CP we set out the detail of our proposed reporting requirements for firms carrying out various credit activities. In making these proposals we have been mindful of the need to be proportionate, concentrating on information we believe is key in informing our supervisory strategies delivered through the three different approaches to supervision.
- 77.** In addition to firms reporting on their activities, for providers of high-cost short-term credit and home collected credit, we are also proposing to collect transactional information on individual product sales or loan transactions. As we have stated in our earlier consultation, 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 customer relationships 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. The detail of our proposals for the collection of product sales data are set out in chapter 4. We are particularly planning to use regulatory data to help us to mitigate the risks posed to customers by the Consumer Credit industry. These include the risk of high losses relative to wealth, the risk of widespread small losses and the inherent risk of escalating consequences if a borrower cannot meet their obligations. There is also the potential for consumer harm as a result of firms in financial difficulties.

## Enforcement

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

- 78.** The majority of respondents agreed with our proposed approach to enforcement, believing that the enhanced powers would result in an improvement in standards in the consumer credit industry.
- 79.** Nearly three quarters of respondents agreed in full with the proposals, with some others agreeing in part. For those respondents agreeing in part, the main points raised were around the proportionality of the regime; concerns over the potential publication of investigations before action is taken; and how the FCA will deal with past conduct.
- 80.** For some respondents liaison with trading standards will be very important to the future effectiveness of the regime. We agree and we will continue our work to develop structures for that liaison as set out in Chapter 2.
- 81.** One respondent was not in favour of the regime due to a perceived problem with the boundary between higher- and lower-risk firms.

### Our response

Our approach to enforcement and our policy and procedure for imposing penalties is set out in the Enforcement Guide (EG) and our Decision Procedure and Penalties Manual (DEPP). We propose applying the same general approach to the enforcement of consumer credit activities as we currently apply in taking enforcement action in respect of other regulated activities under FSMA.

We believe that we have designed a proportionate regime, where the focus will be placed on those firms that pose (or could pose) the biggest risks to consumers. We will take a number of factors into account when deciding whether, and if so what, enforcement action to take. These factors may include consumer detriment (or potential detriment); evidence or risk of financial crime; and evidence or risk of wider problems at a firm.

In relation to publicity EG 6 states that the FCA will not normally make public the fact that it is or is not investigating a particular matter, or any of the findings or conclusions of an investigation except in exceptional circumstances.

We will be able to apply the full FSMA enforcement toolkit to breaches committed after 1 April 2014; for breaches committed before 1 April 2014 we will only be able to apply the sanctions that were in place at that time, including the use of our powers to impose civil penalties for contraventions that attracted such penalties under the CCA. The FCA will put processes in place to manage this distinction. In order to better understand OFT processes, we have seconded some of our members of staff to the OFT (and vice-versa).

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## Complaints and redress

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

- 82.** Respondents commented on the proportionality of the proposed reporting and publishing requirements and the lead times necessary to make changes. However a few respondents thought we should require all firms with more than 300 complaints to publish the information. There was concern that the requirements should not be over-burdensome for companies involved with vehicle leasing.
- 83.** A number of respondents did not support our proposal to extend eligibility to complain to the FOS to all micro-enterprises. Respondents considered that where a loan was outside the OFT consumer credit regime (because it was made to a particular type of micro-enterprise or fell within one of the other exemptions from regulation under the CCA) it was wrong for there to be access to FOS.
- 84.** All stakeholders, including the not-for-profit bodies themselves, supported the principle that not-for-profit bodies providing debt advice should be subject to the FOS jurisdiction. However a number of respondents did not support the proposal that they should be able to choose to 'opt in' to the FOS Voluntary Jurisdiction rather than be subject to the FOS Compulsory Jurisdiction (CJ). The main concern was that, where there is scope for customers to suffer financial detriment due to the inappropriate actions of a regulated entity, they should have the right to the same complaint handling and redress system across the sector. The provision of debt advice is an activity which carries particularly high risks for consumers. However respondents recognised that the immediate introduction of the CJ could create challenges for various not-for-profit providers – the majority of which are not currently subject to the FOS jurisdiction under the CCJ.
- 85.** There was some support for keeping under review the issue of FSCS cover in relation to debt management. However, some respondents considered that there should be FSCS cover from the start of the regime, in particular for debt management.

### **Our response**

We propose that from 1 April 2014 consumer credit firms that have not hitherto been FSMA authorised will need to record complaints. This shouldn't put too much additional burden onto firms, as most of them will already have complaints processes in place.<sup>13</sup>

Our current rules require six-monthly complaints reporting by all FCA-authorised firms and also six-monthly publishing of complaints by firms that receive 500 or more in six months. This means that we have access to information about the complaints firms receive, helping us to supervise how firms are carrying out their business. We believe that publishing complaints data increases senior management focus on complaints and encourages improvements in complaints handling.

In line with our reduced regulatory reporting requirements for consumer credit firms, we proposed in FSA CP 13/7 to require firms carrying on consumer credit

<sup>13</sup> It is in licensees' interests to retain records of complaints so that these can be used to help the FOS if necessary (DISP 1.1.16G).

activities that are not currently authorised by the FSA to report and, where appropriate, publish a relatively small amount of complaints information.

We therefore propose to take a proportionate approach to reporting requirements on complaints. We propose that larger firms should publish complaints data where they have received 500 complaints or more in a six month period and smaller firms, and firms with limited permission, should publish their complaints data where they have received 1000 complaints or more in a 12 month period.

We propose to require firms (except firms with a limited permission<sup>14</sup>) to break down the complaints they receive depending on the consumer credit activity that gave rise to the complaint, for example credit broking or debt management activity. The breakdown broadly follows the breakdown of activity that firms will have to report to us in their regulatory returns. We think this will make complaints reporting easier for firms and will also result in firms providing the complaints information that supervisors need.

We propose that these reporting and publication requirements will not apply to:

- consumer credit firms with only an interim permission;
- credit related regulated activities of existing FSMA-authorised firms with only an interim variation of permission. Until they have obtained a full variation of permission, we propose these firms will continue to report and publish complaints in accordance with current requirements.

This will allow firms a lead in time of up to two years to put in place necessary IT changes.

Our rules currently provide access to FOS not only to individuals (regardless of whether they are high net worth) but also to some other complainants including some small businesses, ie micro-enterprises. We wish to ensure that the same individuals and bodies are eligible to complain to FOS in relation to consumer credit activities as other activities following the transfer to the FCA. There seems to be no justification for different eligibility criteria in relation to complaints about different types of activity. It is also administratively simpler for FOS to operate a single set of eligibility criteria. We have not been persuaded that we need to change our policy approach to extend eligibility to complain to FOS in the way we propose.

Borrowers with loans not regulated under the CCA (because of one of the exemptions) who borrow from firms currently authorised by the FCA will generally have access to FOS in relation to these loans. This is because the CJ is not restricted to regulated activities but covers some unregulated activities carried on by FCA-regulated firms, in particular activities relating to certain consumer credit activities that are not covered by the Consumer Credit Act. As at present, a person doing business with a firm not authorised by the FCA will not have access to the FOS unless the firm has opted in to the VJ. We propose to continue this approach following the transfer to the FCA.

<sup>14</sup> These firms will publish only the number of complaints received unless they are a not for profit debt advice body holding £1m or more in client money.

We have discussed the position of not-for-profit bodies providing debt advice with a number of the not-for-profit groups whose members provide debt advice and, in the light of these discussions, we now propose that all these bodies should be subject to the Compulsory Jurisdiction. All the groups that we spoke to strongly supported the principle that consumers should have a right to redress in respect of regulated credit services received, regardless of whether or not they paid a fee for those services.

We do not propose to introduce FSCS cover on the transfer of consumer credit to the FCA but we will keep the position under review, in particular as regards the debt management sector. There are a number of other protections which will apply. The key protections are:

- more stringent client asset standards for debt management companies (for example annual audits of client money, regular reconciliations);
- debt management companies will have to assign responsibility for client money to an approved person;
- debt management companies will be subject to prudential standards; and
- increased supervision.

These protections are a significant increase in regulation and consumer protection over and above the protection provided under the CCA in relation to the activities of firms licensed by the OFT. However we do not have the data to quantify the amounts of client money at risk and whether these protections will be sufficient. We also want to avoid other authorised firms paying for the problems of the past as firm failures at the start of the new regime are likely to reflect business practices before the firms were regulated by the FCA.

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## Preventing financial crime

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

- 86.** Most respondents agreed with our approach to preventing financial crime, believing that it is right that the emphasis for tackling financial crime is placed on firms, for the benefit of consumers.
- 87.** While the majority of respondents agreed in full with our proposals, several agreed partially or agreed and expressed some limited concerns. The main concerns were in relation to:
- whether the FCA would take a risk based approach to its financial crime oversight of consumer credit firms;
  - the step up that would be required of some firms to meet the new financial crime obligations placed on them;
  - the appointment of a Money Laundering Reporting Officer (MLRO) from abroad;

- money laundering supervision of those currently exempted by group licence; and
- the supervision under the Money Laundering Regulations (MLRs) of some consumer credit firms who undertake Money Service Business (MSB) activity in addition to consumer credit.

### Our response

The FCA approach to financial crime is that we focus our resources on firms particularly exposed to financial crime risk; this will apply to consumer credit firms in the same manner as other firms subject to the FCA's financial crime rules. The financial crime rules also provide that policies and procedures must be "comprehensive and proportionate to the nature, scale and complexity of its activities". We recognise that this might be a challenge for some firms, but there is guidance provided by other bodies and helpful material in our financial crime guide that will support firms in making any amendments they need to existing systems and controls.

Where there is an obligation for a firm to appoint an MLRO, our guidance states that we expect a firm's MLRO to be based in the UK. Where an MLRO is based elsewhere firms will need to be able to satisfy the FCA that the MLRO is able to undertake the role effectively.

The amendments to the MLRs will ensure that the supervisory arrangements for consumer credit firms who also provide MSB activity that are currently in place are maintained, with HMRC being responsible for supervision of these firms.

The concept of a group licence will not exist in the new regime. This means that firms who previously held a group licence will now be subject to supervision under the MLRs unless they qualify for an exemption under the MLRs because they provide consumer credit by giving customers time to pay for the provision of services which they themselves provide and the time to pay covers a period of 12 months such as gym or golf club membership. A firm may also be exempt if they are doing the consumer credit activity on an occasional or very limited basis. For firms who are members of a professional body named as a supervisor under the MLRs, we will work with those bodies to agree the most effective supervisory arrangements. Any other firm subject to the MLRs will be supervised by the FCA.

### Fees

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

- 88.** We published a summary of the feedback we received to this question and our response in our policy statement (Policy Statement 13/7): FCA Regime for consumer credit; information on charges to the scope of the regulation and interim permission fees.<sup>15</sup>

<sup>15</sup> <http://www.fca.org.uk/your-fca/documents/policy-statements/ps13-07>  
<http://www.fca.org.uk/your-fca/documents/policy-statements/ps13-08>

89. This included our decisions on the fees we are charging for interim permission and the discounts offered.

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

90. There was almost unanimous support for our proposal not to collect a general FOS levy from firms with an interim permission to carry out consumer credit activities until they have FCA authorisation. However some respondents noted that firms might have paid the Consumer Credit Jurisdiction (CCJ) £140 five-yearly levy only fairly recently so the proposed approach would not particularly benefit these firms.

**Our response**

We have decided to continue with our proposal and will not collect a general FOS levy from firms until they have FCA authorisation to carry out consumer credit activities.

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**Market failure analysis**

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**Q27: Do you agree with our market failure analysis?**

91. We discuss the responses we received to this question in Annex 2 to this paper.

**Cost benefit analysis**

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

92. We discuss the responses we received to this question in Annex 2 to this paper.

**Second charge loans**

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**Q29: Do you have any comments regarding our proposed approach to second charge lending?**

93. Respondents to the consultation were generally supportive of our proposed approach to the interim regime. It was recognised that having second charge loans in the consumer credit regime was a pragmatic solution until the longer term regime could be designed and implemented.

## Our response

Given the support received for our proposed approach, we intend to proceed with treating second charge loans in a similar way to other forms of consumer credit while in the consumer credit regime. The exception to this is reporting and we have set out our proposed approach in Chapter 11.

The conduct standards are outlined in Chapter 5 and the draft rules and guidance are in Appendix 2. The draft rules and guidance include provisions reflecting the relevant sections of 'Second charge lending - OFT guidance for lenders and brokers'. Where the CCA or OFT guidance has treated second charge mortgages differently to other consumer credit products, these differences have been read across into our proposed conduct rules.

For financial promotions, some advertisements for second charge loans are already regulated by FCA rules for mortgages, rather than CCA requirements. This applies where the advertisement relates to products from lenders who offer both first and second charge loans.

We are proposing that, following the transfer in April 2014, those advertisements already subject to FCA mortgage rules will remain subject to these until the longer term regime is implemented.

For advertisements that are currently subject to the CCA requirements (the Consumer Credit (Advertisement) Regulations 2004), we are proposing that these same standards will apply from April 2014. This includes the conduct standards relating to advertising in OFT guidance, which applies to second charge firms, even if the advertisement is subject to FCA rules already. The drafts of these requirements are in CONC 3. A second charge lender will have to comply as any other lender with the general financial promotion rules, including the clear fair and not misleading rules, and the rule on non-written promotions and the prohibition on approving financial promotions for unauthorised persons.

## Equality impact assessment

**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?*

94. We discussed the responses we received to this question in Annex 6 to this paper.

## Annex 2

# Detailed feedback on the MFA and CBA in CP13/7

### Introduction

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1. In this Annex we summarise the responses we received to the market failure analysis and the cost benefit analysis presented in FSA CP13/7. In addition, it sets out our response to this feedback and how these consultation responses have informed the analysis in this consultation paper.

### Market Failure Analysis

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#### *Q27: Do you agree with our market failure analysis?*

2. Most respondents who provided a view on the market failure analysis either agreed with or agreed in part with our market failure analysis
3. We identified several themes in the responses on our market failure analysis (MFA). These are:
  - **The MFA was too high-level and did not do justice to specific sectors.** Several respondents stated that the FCA should undertake detailed analysis of sectors other than subprime sectors. Another response requested that we carry out more detailed analysis of non-mainstream lenders. In addition, one respondent argued that some of the general market failures identified were predominantly associated with payday lending, which only accounts for a small proportion of consumer credit lending overall. Another stated that there was too much focus on the supply of credit and insufficient discussion of credit brokerage.

#### **Our response:**

The aim of our MFA was to capture, at a broad level, the main market failures across the different consumer credit segments. It was not feasible to cover markets in detail. In doing so, we accept we have not fully captured details that are important to particular markets and that there is further work to be done to strengthen our understanding of these markets. In this CP, we have also carried out further research to identify problems in particular markets where our proposals go significantly beyond what is already required under the CCA, including in the substantial OFT Guidance. In particular, the high-cost short-term credit proposals have been developed building on a range of available evidence, including a review of UK and international payday lending evidence. We are also continuing to build our expertise and experience of consumer credit markets. Also, the responses and evidence provided to FSA CP13/7 and to this CP will inform our continuing work. In particular, they will inform a forthcoming document publishing our approach to regulation of consumer credit going forward. This will include more detailed analysis of market failures in markets that the FCA considers to be of particular interest. We expect this document to be published in Spring 2014.

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- **The MFA did not discuss or take past regulatory interventions sufficiently into account and how these have mitigated market failures.** Some specific responses were that we overstated the risks of credit card consumers falling into debt because of the 2010 industry agreements on credit cards, for example on minimum monthly payments. Another respondent mentioned the standard European consumer credit information form, which helps credit consumers to make more informed choices. While another respondent pointed to the remedies the Competition Commission introduced in the Home Credit market.

#### Our response:

In line with our previous response on the detail of the MFA, we accept that further detail on past regulatory interventions and their effectiveness is important for building a strong understanding of different markets. As we develop more detailed analysis of particular consumer credit markets, past regulatory interventions and the extent to which they have mitigated risks to consumers or led to problematic unintended consequences will be considered. We will also be working with other public bodies and regulators, particularly the OFT, the Competition Commission (and in time the new Competition and Markets Authority) to ensure we make the most of their expertise in consumer credit. In addition, we will also look at areas that may have received less regulatory attention in the past and develop our own regulatory approach to these.

- **The MFA did not adequately capture substitution effects between different forms of credit.** There were several responses on substitution from credit cards to short-term loans. In particular, one respondent argued that a move from credit cards to short-term loans, for example, payday loans, need not indicate a market failure, arguing that with greater economic uncertainty consumers are less willing to take on longer term debts. Others criticised our claim associating the drop in credit card credit with the increase in payday lending, pointing out that the drop in credit card lending far exceeded the increase in payday lending. Another substitution effect that several respondents highlighted was the risk that borrowers would be driven towards illegal forms of lending, particularly if short-term, higher cost forms of lending became more expensive or more difficult to access. While one respondent argued that it was important to consider sub-prime retail credit products as a substitute for purchases made using home credit.

**Our response:**

We agree that substitution between different credit products and services is important to understand economic markets and to understand how and whether regulatory interventions will be effective. We are also keen to identify ways in which consumers who find themselves unable to access mainstream credit products may be driven to less mainstream credit products and may face higher risks as a result. Consumers being driven towards illegal money lenders is one extreme, but evidence suggests, rare example of this.<sup>1</sup> And, as in our responses above, we will be investigating possible substitution channels in our continuing market failures analysis, including in our forthcoming forward-look document on consumer credit.

- **The MFA did not sufficiently take into account characteristics of vulnerable consumer groups.** One respondent emphasised the importance of credit for the disabled and described in depth the particular difficulties faced by these consumers. Another respondent criticised the MFA for not having a greater focus on consumer-side drivers of choice and for the impression the market failure analysis gave that some of the problems in consumer credit were the responsibility of the consumer rather than firms. Another respondent stated that the FCA needed to have a clear strategy to ensure consumer protection and competition measures work well for vulnerable consumers.

**Our response:**

Consumers, particularly those that are at greater risk of detriment from market and regulatory failures, are a central concern for the FCA. For example, the key parts of the OFT's Mental Capacity Guidance have been set out in the draft conduct rules and hence will continue to be an important part of the regime (see CONC 2.10). More broadly, we agree that understanding the consumer-side drivers of choice is important. For these reasons, the FCA, as part of continuing work on understanding the consumer credit market, is considering market research focusing on the consumer experience of consumer credit. We are also strongly committed to using behavioural economics to improve our understanding of consumers in consumer credit.

**Cost Benefit Analysis****Q28: Do you agree with the costs and benefits identified?**

4. The majority of respondents who provided a view on the cost benefit analysis disagreed with our analysis.

<sup>1</sup> The Personal Finance Centre, University of Bristol's 2013 report, 'The impact on business and consumers of a cap on the total cost of credit', found that vast majority of consumers in their survey would not consider using an illegal lender when facing limited access to credit. The report is available at: [www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1302.pdf](http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1302.pdf).

5. We identified several themes in the responses on our cost benefit analysis (CBA). These are:
- **The CBA underestimated the compliance costs that firms will incur.** A range of costs were cited as either not having been adequately considered or having been underestimated; for example, costs from the approved persons regime, appointed representative regime, the cost of changing regulatory disclosure, and costs of carrying out reviews of systems and implementing changes. A few respondents argued that since our cost estimates were based on a survey of firms before policy proposals were clear, that these estimates were likely to be poor. One respondent argued that there was no indication that the costs from the implementation of Consumer Credit Act 2006 and Consumer Credit Directive had been taken into account. Several respondents disagreed that compliance costs for OFT-licensed firms would be limited by the fact that much of the CCA rules and OFT guidance is being transferred into FSMA. Some respondents argued compliance costs underestimated the costs that would be incurred because FCA regulation is more principles-based than the OFT, thus more uncertain for firms and costs will depend in part on how industry expects the FCA to act.

#### Our response:

Europe Economics (EE) have taken on board feedback obtained to the CBA in FSA CP13/7 and other new evidence to improve estimates of compliance costs. In particular, EE have revised the on-going cost of the appointed representative regime in light of feedback from respondents and have increased their estimate of the time needed for firms to spend on approved persons.

In relation to the survey predating the proposals, this is an issue that Policis and EE were aware of, it is also one of the reasons that the approach to the CBA was designed not to rely on firms' evaluation of the compliance costs of the proposals and transfer. Instead, information was elicited in the firm survey on the compliance activities they carry out and this was used to construct compliance cost estimates. This had the advantage of allowing changes as policies developed, for example, revising estimates on the time and the extent of activities firms would need as policies changed and the changing estimated compliance costs from this.

EE did consider whether the costs from the Consumer Credit Act 2006 and the Consumer Credit Directive were a good precedent for estimating costs for this new regime. However, EE's view is that the nature of the regime transfer is qualitatively different from these past regulatory changes, with the crucial differences being the mapping across of existing conduct rules and our view that we do not expect the transfer to affect existing contracts to require the re-papering of those contracts.<sup>2</sup> More generally, on the effect of existing regulation (repealed CCA, including its secondary legislation and OFT guidance) being transferred into FCA rules and guidance, we expect that additional costs to firms should be limited, with additional costs being primarily expected where increases in supervisory and enforcement resources incentivise improvements in compliance.

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<sup>2</sup> Although firms will need to adjust references to their regulators in documentation, etc. issued from 1st April 2014.

Also, EE acknowledge the possibility that costs may increase if firms react on the basis of the expectation of more interventionist approach from the FCA. However, they also note that this downside case is hard to judge, as it depends on the psychology of the sector. They note, however, that they expect that most firms will adopt a 'wait and see policy'. We are committed to ensuring firms are well informed about the transfer to limit downside impacts from uncertainty about the new regulatory regime.

- **The CBA underestimated the level of market exit expected from the transfer.** A significant number of respondents argued that our CBA underestimated market exit from the transfer, both generally and by particular groups of firms. A recurring point made was that smaller firms in particular would be more likely to exit. Particular drivers cited were difficulties for small firms in adapting to the change in regulator and to the increase in fees. A few respondents mentioned that the additional burdens would lead to significant exit among debt collection firms and for fee-charging debt management firms. Also on the population of debt management firms, several respondents pointed out that our estimate for the current number of debt management firms should have been in the range of 250-300 not 1700. While on debt collection firms, one respondent argued that given the low value of turnover for many of these, that exit among these would be closer to the exit estimates for non-bank and credit broker lenders levels.

#### Our response:

In addition to the changes made by EE to take into account feedback on compliance costs (which in turn affects predicted exit) they have also revised some of their assumptions on firms' exit behaviour. This has in part been driven by the revised evidence on the population of firms in the market, which revealed a greater number of firms whose consumer credit is marginal (i.e. a small part of overall business). This change in the evidence led EE to increase its estimates of market exit for certain segments, both in terms of 'natural wastage' i.e. firms expected to exit independently of the transfer of regulator and also exit from the regime change. For example, for debt collection firms the expected level of exit has increased, and is now closer to the exit levels expected for non-bank lenders and credit brokers.

On the population estimate of debt management firms, the estimate also included (and the new population estimate includes) free-to-client debt advisers and firms that carry out other related activities, for example, insolvency practitioners with a consumer credit licence. These additional firms account for the difference pointed out by respondents.

- **The CBA understates certain detrimental outcomes from the transfer.** One respondent challenged the assumption that bank and non-bank lenders will provide additional credit as a substitute to a reduction in credit provision by non-bank lenders serving point of sale credit brokers, from exit by brokers and non-bank lenders. Their view was that the decrease in supply of point of sale of credit would be greater and consumers more impacted as a result. One respondent emphasised that increased costs of regulation will be passed through to consumers and that consumers will suffer from reduced competition and reduced access to credit.

**Our response:**

As in other areas, EE has revised its analysis of impacts on consumers in light of new evidence, including information provided as feedback to FSA CP13/7. Partly as a result of these responses, the CBA in this CP does not assume substitution by bank and non-bank lenders for the decrease in non-motor point of sale lending, leading to larger reductions in the volume of lending. EE has also revised its estimates of the cost pass through to consumers of compliance costs, which are somewhat higher than those estimated previously, reflecting higher compliance costs and acknowledgement that additional compliance costs will at least in part be borne by consumers.

**The CBA overstates the benefits expected from the regime.** Among a significant proportion of respondents, there were challenges as to whether there would be consumer benefits from the transfer and whether these would be to the extent specified. Some of these were directed to the government's impact assessment. Others focused on the analysis and estimate of benefits presented in our CBA. For example, one respondent expressed surprise that we did not estimate the benefits from tighter regulation of debt management firms and payday lenders, though they did not provide any evidence or indication as to how it should be done. Another respondent pointed out that our estimated benefits are a transfer from firms to consumers, then these will in turn be borne as costs to other consumers since the additional costs will be passed through to consumers. Another queried whether increased redress was purely a benefit to consumers, given the recent experience of CMCs with PPI.

**Our response:**

We accept that there were limitations to our estimate of benefits in our CBA. In order to improve our analysis of benefits for this CBA, we commissioned EE to analyse and estimate the benefits. EE analysis of benefits takes a fresh look at the expected impacts of the regime, for example on the NAO estimate of detriment used in the Her Majesty's Government's Impact Assessment on the transfer. It also looks in greater detail at the benefits from markets such as payday lending and debt management where more significant regulatory interventions are being consulted on.

## Annex 3

# List of non-confidential respondents

Association of Certified Chartered Accountants (ACCA)

Abundance Generation

Advertising Standards Authority (ASA)

Allen & Overy LLP

Assetz Capital Limited

Association of Bridging Professionals

Association of British Credit Unions Limited (ABCUL)

Association of British Insurers (ABI)

Association of Business Recovery Professionals

Association of Chief Trading Standards Officers

Association of Finance Brokers (AFB)

Association of Mortgage Intermediaries (AMI)

Association of Professional Compliance Consultants

Association of Professional Debt Solutions Intermediaries

Association of Short Term Lenders

Aviva

AXA UK Group

BCCA

Baines & Ernst

Bates Wells & Braithwaite London LLP

Bexhill UK Limited

Big Society Capital

Bridgend County Borough Council

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British Bankers Association (BBA)

British Retail Consortium (BRC)

British Vehicle Rental and Leasing Association (BVRLA)

Capital One (Europe)

capQuest group

Community Development Finance Association (CDFA)

Central England Trading Standards Services

Central Loans Limited

Chartered Accountants Regulatory Board

Christians Against Poverty

Citizens Advice

City of London Corporation

Civil Court Users Association (CCUA)

Coastal Loans

Consumer Council Northern Ireland

Consumer Credit Trade Association (CCTA)

Consumer Finance Association (CFA)

Corporate and Legal Group

Creative Sector Services Ltd

Credit Action

Credit Services Association (CSA)

Debt Resolution Forum

Debt Managers Standards Association (DEMSA)

Eva Lomnicka

FCA Practitioner Panel

fh Debt Solutions Ltd

Finance and Leasing Association (FLA)

Financial Inclusion Centre  
Financial Services Consumer Panel  
Funding Circle  
Glasgow Trading Standards  
Greater London Authority  
Gregory Pennington Limited  
Homes for Scotland  
Insolvency Practitioners Association  
Institute of Credit Management (ICM)  
International Underwriting Association  
Lending Standards Board Lending (LSB)  
Lloyds Banking Group  
Local Trust  
Money Advice Scotland  
Money Advice Service  
Money Advice Trust (MAT)  
Money Village  
MoneyPlus Group  
National Franchised Dealers Association  
Nick Lord Interested academic  
Ocean Finance  
PayPlan  
Pentagon (UK) Limited  
Pricewaterhouse Coopers  
Provident Financial  
RadioCentre  
Ratesetter

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ReAssure

Richmond Group

Royal SunAlliance

Scope

Scottish Illegal Money Lending Unit

Society of Chief Officers of Trading Standards in Scotland

Solicitors Regulation Authority

St James's Place Wealth Management

StepChange

The Advertising Association

The Association of Professional Financial Advisers (APFA)

The Direct Marketing Association (UK) Limited

The Incorporated Society of British Advertisers Ltd (ISBA)

The Independent Financial Resolutions Group Limited

The Institute of Chartered Accountants in England and Wales (ICAEW)

The Institute of Chartered Accountants of Scotland (ICAS)

The Law Society of Scotland

The Law Society of Scotland's Investor Protection Sub Committee

The Peer to Peer Finance Association

ThinCats

Th!nk Finance

Trowers & Hamlins

TxtLoan

UK Cards Association

UK Consumer Credit Reference Agencies

Wescot

Which?

WorldPay (UK) Ltd

Zero-credit

Zopa Limited

## Annex 4

# List of questions

- Q1:** Do you have any comments on the way our threshold conditions are being applied to consumer credit firms and/or the updates to our Handbook rules?
- Q2:** Do you agree with the updates to our draft Handbook rules for approved persons for consumer credit firms?
- Q3:** Do you have any comments on the updates to our draft rules regarding appointed representatives of consumer credit firms?
- Q4:** Do you have any comments on the criteria that we are proposing a person would have to fulfil to be a self-employed agent of a principal firm (as set out in Appendix 2)?
- Q5:** Do you have any comments on our proposed regulatory reporting regime?
- Q6:** Do you agree with our proposals to collect product sales data on high-cost short-term lending and home collected credit?
- Q7:** Do you have any comments on how we propose to carry across CCA and OFT standards, in particular in the areas highlighted above?
- Q8:** Do you have any comments on our proposed approach to financial promotions?
- Q9:** Do you agree with the definition of a high-cost short-term credit provider as set out at the start of this chapter?
- Q10:** Do you have any comments on limiting rollover to two attempts?
- Q11:** Do you have any comments on whether one rollover is a more appropriate cap?
- Q12:** Do you have any comments on our proposal to introduce a limit of two unsuccessful attempts on the use of CPAs to pay off a loan?
- Q13:** Do you have any comments on our proposal to ban the use of CPAs to take part payments?

- Q14:** Do you have any comments on our risk warning?
- Q15:** Do you have any comments on our proposals to require high-cost short-term lenders to provide information on free debt advice before the point of rollover?
- Q16:** Do you have any comments on the effectiveness of price capping?
- Q17:** Do you agree with our proposals on how to calculate our prudential requirement for debt management firms and some not-for-profit debt advice bodies? If not, what amendments would you suggest, and why?
- Q18:** Do you agree with our proposal to apply a transitional approach to prudential standards for debt management firms and some not-for-profit debt advice bodies?
- Q19:** Do you have any comments on our draft guidance on the debt counselling activity and our draft rules covering the provision of debt advice?
- Q20:** Do you have any comments on the rules that we propose to apply to peer-to-peer lending platforms to protect borrowers?
- Q21:** Do you agree with our proposals for debt management firms and not-for-profit debt advice bodies that hold client money? If not, which aspects of the regime do you disagree with and why?
- Q22:** Do you agree with our proposed implementation timetable? If not, please give reasons.
- Q23:** Do you agree with our suggested amendments to the reporting requirements for second charge loans?
- Q24:** Do you agree with our proposal to allow all microenterprises to complain to the ombudsman service?
- Q25:** Do you agree with our proposal to include not-for-profit bodies providing debt advice in the Compulsory Jurisdiction?
- Q26:** Do you agree with our proposals on recording, reporting and publishing complaints?
- Q27:** Do you agree with the costs and benefits identified?
- Q28:** Do you agree with our assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?

## Annex 5

# Cost benefit analysis summary

1. This Annex presents a summary of the cost benefit analysis (CBA) of the proposed consumer credit regime. External consultants, Europe Economics (EE), were commissioned to carry out the CBA. Although this Annex summarises the key conclusions of the CBA, their report should also be read for completeness.<sup>1</sup>
2. Section 138I of FSMA requires us to publish a CBA unless in accordance with section 138L we believe there will be no increase in costs or that the increase will be of minimal significance. In addition, section 138I requires us to publish an estimate of costs and benefits unless they cannot be reasonably estimated or it is not reasonably practicable to produce an estimate.
3. There are also special provisions which apply to this CBA (Articles 61 and 62 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No2) Order 2013) SI 2013/1881. 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 (or have the same effect or substantially the same effect as) provisions of the CCA or statutory instruments made under it or OFT guidance.<sup>2</sup> Where the CBA requirement applies, '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.
4. These provisions mean we need to provide a CBA of the incremental impacts of the change of regime, rather than providing a CBA of the whole of the existing regime in addition to the changes to the regime we are proposing. Thus, the CBA presents an analysis and estimates of the costs and benefits of the proposed FCA regime as compared with the existing OFT regime.
5. In accordance with section 138I of FSMA, the CBA carried out by EE presents an estimate of the costs and benefits of the package of proposals consulted on here. However, EE's estimate of the benefits is partial in that it covers only reductions in 'observed' detriment i.e. detriment consumers are aware of and attribute to some consumer credit activity. Many forms of detriment are 'unobserved', for example, where borrowers are unaware they are paying in excess of the competitive price. Many of the economic benefits of the change in regime will be reductions in 'unobserved detriment' and have not been estimated. Similarly, EE did not estimate the cost to firms and consumers of prevented transactions that would not have led to consumer detriment. In its analysis, EE concluded it was not possible to estimate these benefits and costs because of limitations in the availability of data, limitations in the quality of data that was available, and in some cases inherent difficulties in analysing the complex market outcomes.

<sup>1</sup> The Europe Economics report is available at [www.europe-economics.com/publications/15/publications.htm](http://www.europe-economics.com/publications/15/publications.htm).

<sup>2</sup> Rules of the same type are also excluded from the competition duty under section 1B(4).

6. As a result, if we had simply treated their estimate of the benefits from observed detriment as a conservative, lower bound estimate for the benefits overall, we would have significantly underestimated the benefits from the transfer, particularly in areas such as our high cost short-term credit proposals that go well beyond the existing regime and specifically aim to materially reduce unobserved detriment, for example, by reducing unaffordable payday lending.
7. Underlying these difficulties in estimating benefits is the fact that whether consumers benefit or not from the change in regime depends on an extremely diverse set of circumstances, many of which are inherently difficult to observe, including whether they are choosing 'rationally'. This diversity implies data to estimate benefits and certain costs needs to be wide-ranging and sufficiently fine-grained to capture the factors that drive consumer choices and the outcomes these choices lead to. Unfortunately, in consumer credit segments there is a lack of available data of this quality and depth.
8. For example, in the payday market, some borrowers affected by our high cost short-term credit proposals would be prevented from rolling over a payday loan where a roll-over would be a reasonable and informed choice (and so truly reflect their preferences). These borrowers would suffer detriment (lost welfare) from being prevented from rolling over the loan. In contrast, other affected borrowers would be similarly prevented from rolling over a loan, but for them the choice to roll-over would not have reflected their best interests (e.g. they would get into unsustainable financial difficulties, they would be pressured to roll-over, they would underestimate the cost etc.). These borrowers could benefit from the proposals, for example, if they instead choose more suitable credit. Discriminating between these two groups of borrowers, however, is not straightforward, since it requires data to identify the borrowers who are reasonably choosing to roll-over. Moreover, issues are further complicated in that the borrowers who choose payday loans that are not in their best interests could also be driven to worse alternatives by our proposals, for example, driven to borrow from illegal lenders. Determining whether this would happen requires data to predict the options that would be available to which borrowers, which choices borrowers would then make and what outcomes these choices would lead to (which requires a great deal of additional data, including about borrowers' circumstances and data to analyse what markets would be willing to offer them instead of payday loans).
9. While these are difficult challenges, we believe that further explanation is warranted of why additional data-gathering to help estimate the benefits and costs of our high cost short-term credit proposals was not undertaken, particularly as this is the area where we would expect a material reduction in unobserved detriment. The FSA's analysis in the CP11/31,<sup>3</sup> which estimated impacts of our responsible lending proposals as part of the Mortgage Market Review (MMR), including benefits to consumers based on a well-being analysis. This could provide a template for estimating benefits in the present case. However, unlike in the MMR, we do not have lending transaction data, data on loan performance and the BHPS dataset<sup>4</sup>, which provided the data for our analysis of changes in well-being. We also lack the consumer credit counterparts of the mortgage credit and housing variables that were used in the MMR to link consumers' situations with their well-being, which was a critical step in the estimation of benefits there. An obstacle to our gathering data is that our regulatory powers over payday lenders do not take effect until 1 April 2014. Until that point we are unable to compel firms to provide us with any data. Nonetheless, we gained access to the data collected from payday lenders by the OFT during its compliance review and data on CPA usage by payday lenders from a bank. These additional data, though helpful, were not sufficient to carry out an estimation of the wider benefits.

<sup>3</sup> [www.fca.org.uk/your-fca/documents/consultation-papers/fca-cp11-31](http://www.fca.org.uk/your-fca/documents/consultation-papers/fca-cp11-31)

<sup>4</sup> British Household Panel Survey.

10. As is clear from the foregoing, any further estimation of benefits and costs would have required very substantial data gathering. Moreover, the reliability of the data would have been questionable. For example, estimation of well-being is significantly inexact even when long-term panel data such as the BHPS allow one to control for individual characteristics of those reporting their well-being. The extent of the reliability of the BHPS cannot be replicated through a one-off consumer survey. In addition, behavioural evidence suggests that in the present case we would have to contend with widespread under-reporting of debt. This is an important problem, as are errors in consumers' recollection of rollovers and use CPAs, given, as explained above, that we do not have access to representative data on transactions across the relevant population of firms. Thus we believe that further data gathering would require the deployment of significant additional time and resources but not reduce the uncertainty in the benefits and costs sufficiently to affect our view that our proposed high cost short-term credit proposals are beneficial, given the evidence we already have, which is described further below.
11. Specifically, there is strong evidence of consumer detriment associated with payday lending (for example from the recent OFT compliance review) and the continuing rapid growth in payday lending. These also strongly indicate that delaying action to gather further data would likely lead to continuing and growing consumer detriment among a significant number of payday borrowers.
12. Moreover, as discussed in detail in Chapter 6 of the CP, we think there are strong grounds, based on wider evidence, common sense and our regulatory experience to believe that our high cost short-term credit proposals should benefit consumers, particularly the stronger proposals to limit roll-overs and CPA usage to reduce incentives on firms to lend unaffordably.
13. Given all this (the difficulties and delay if we took steps to gather additional data, the limited incremental value of any new evidence we could generate from these data relative to the evidence we already have, and the evidence indicating that delay would allow detriment in the payday market to continue and to grow), we came to the judgement that, in accordance with Section 138I (8)(a) and (b), the costs and benefits could not reasonably be estimated more fully, nor was it reasonably practicable to do so.
14. Nonetheless, we worked with EE to help them to make an estimate of the benefits of the change in regime, and in certain areas, such as payday, supported their work to provide as informative a qualitative analysis of the key impacts on consumers (both benefits and costs) as possible, using the available data and the additional data that we and EE considered it proportionate to gather.

### Key impacts and their associated costs and benefits

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#### Payday lending and debt management proposals

15. EE expect the greatest impacts from the transfer to be in segments where we are proposing rules that go significantly beyond the current regime. In particular, EE expect:
  - the high cost short term credit proposals, if effective, and the transfer to the FCA regime to lead to exit of between 25% and 30% of payday lenders, a reduction in payday revenue of up to £200m, an initial reduction in payday lending of between £625m and £750m from firms, as firms adjust to stop lending to borrowers they no longer expect to be profitable under the new proposals (EE particularly expect payday lenders to change the borrowers they target in response to the proposed CPA and rollover limits) with between 18% to 30% of payday consumers losing access to payday credit

- the debt management proposals to lead, with the transfer, to significant increases in costs on debt management firms. EE do not expect these increases in costs to drive large levels of exit from the market because of the high levels profitability in the segment; they estimate exit of 5 to 10% of firms from the change in regime, concentrated among the smaller commercial debt management firms. EE also note, however, a strong likelihood that additional costs will be passed through to consumers, though additional costs are expected to be small relative to the price already paid by consumers
16. EE identify two main forms of consumer detriment in the payday loans market. The first is that from unaffordable loans. EE present evidence of lenders not carrying out adequate affordability assessments and of using CPA to secure payments from borrowers' income as it enters their bank accounts, weakening borrowers' ability to prioritise payments and also weakening lenders' incentives to check loans are initially affordable. The second is detriment from the poor treatment of, and from unsuitable advice being given to consumers facing repayment difficulties. EE present evidence of consumers being unsuitably advised to rollover loans, of consumers rarely being offered forbearance when experiencing payment difficulties, of aggressive debt collection practices, and of the use of CPAs to bombard consumers' accounts with payment requests, leading to severe distress in some cases.
  17. Benefits of our proposals will arise by reducing these forms of detriment. EE analyse qualitatively the benefits to payday consumers of the change in regime including the high cost short-term credit proposals. In Table 7.4 of their report, they judge that our proposals will be strongly effective in reducing detriment, particularly unaffordable lending, detriment from poor value products or services and detriment from unsuitable advice.
  18. In their more detailed analysis of the proposals, EE expect that, although the risk warning and affordability assessment should help, the greatest impacts on detrimental lending from the rollover cap and CPA limitation. The package of proposals is expected to benefit consumers who are prevented from obtaining a loan that they would not be able to afford and who do not instead access more detrimental options, such as illegal lending. For example, the proposed limitation on CPA should also increase incentives on lenders to assess affordability i.e. to ensure that borrowers can (voluntarily) pay back their loan. However, EE also note that some consumers who are borrowing affordably and not suffering from detriment will face restricted access. Whether these consumers benefit depends on whether the payday credit they lose access to was a better option than the alternatives they are pushed to choose instead.<sup>5</sup>
  19. Also, the reduction in lending to borrowers will imply that some borrowers (18% to 30%) are expected to lose access to payday credit, and among these, borrowers who have no other credit alternatives will lose access to credit.<sup>6</sup>
  20. EE analysed how three broad consumer groups (low-risk, moderate -risk and high-risk)) might be affected by the high cost short-term credit proposals and what alternative scenarios they might lead to. Their estimate suggests that between 20% and 30% of moderate-risk and 30% to 50% of high-risk borrowers will be affected by the proposals by the restriction in lending. Among these borrowers, they expect up to 30% to do without credit and up to 40% to turn to friends, family or other sources of grey lending. They expect up to 15% of the high-risk borrowers to turn to other forms of high-cost credit. For moderate risk borrowers, they expect a proportion of this group to be in a position to afford payday credit, but to be denied access as a result of the proposals, and thus to suffer detriment.

5 The evidence that payday consumers can be swayed in their choices by behavioural biases, for example from unduly focusing on speed and convenience rather than price, could mean that some of the borrowers who lose access to payday credit, even if they could be borrowing affordably, may enjoy improved outcomes by being pushed to an alternative credit product.

6 However, some of these borrowers may benefit if their lost access means they are pushed toward more beneficial alternatives.

21. Overall, EE give a high-level indication of benefits to consumers. They expect about half of the affected borrowers (17% of borrowers overall) to be led to better outcomes, a slightly smaller proportion (12% of borrowers overall) to be led to outcomes for which it is unclear whether these are better or worse, and a small proportion (2% of borrowers overall) to have worse outcomes.
22. Since EE did not have access to more detailed evidence on how individual consumers (or consumer types) are made better or worse off by having a payday loan and to what extent, they were not able to estimate the extent to which a restriction in access to payday credit would reduce detriment for specific borrower groups and for borrowers overall.
23. Another important caveat is that the above estimated impacts assume the payday proposals are not circumvented by lenders. EE present some international evidence to suggest appropriate further measures can help to prevent circumvention of a rollover cap. Specifically, they point out it may be necessary to introduce monitoring, for example, a real time database of borrowers' loans to successfully enforce a cap.
24. EE also expect the debt management proposals to lead to benefits. The prudential standards should incentivise firms to act more prudently and to aid orderly wind down in case of insolvency. The client asset proposals should increase the likelihood that client assets would be ring-fenced in the event of insolvency and so reduce potential losses of client money and assets. Finally, the proposal to require that fees be reasonable, consistent and structured towards the sustainability of the debt management plan should help mitigate detriment arising from unsustainable debt plans where fees are paid that enable the debt manager to recover their set-up costs at the beginning of the plan; it also benefits the consumer by reducing their debt more quickly, since their creditors receive repayments earlier in the plan.

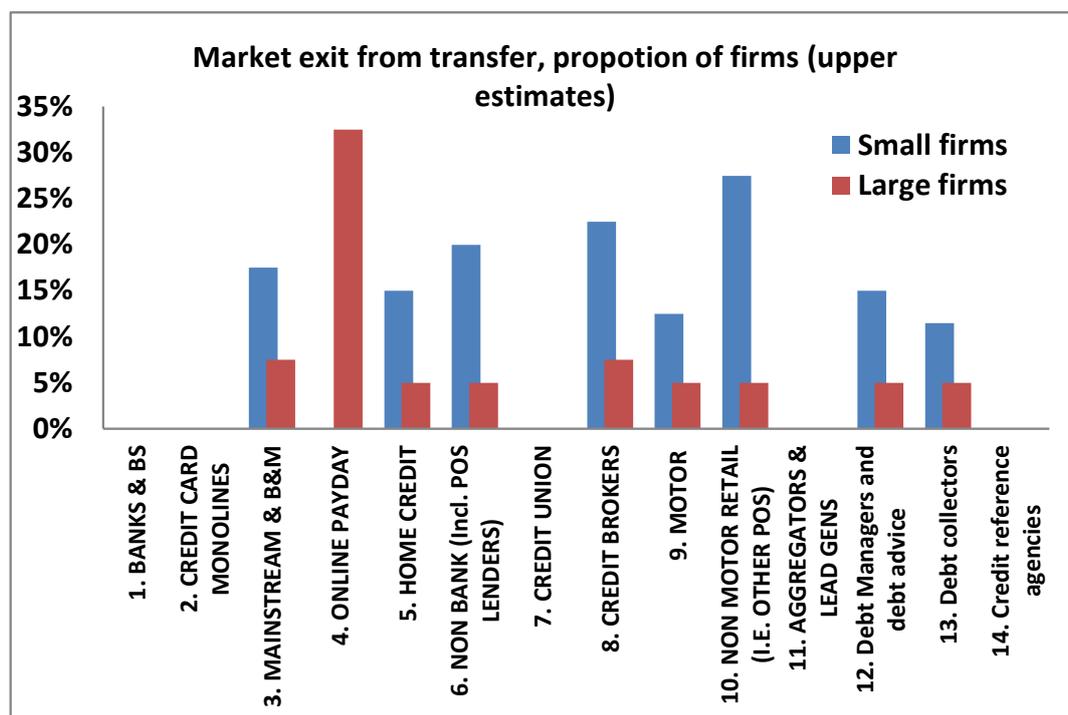
#### **General impacts of the change in regulatory regime**

25. EE expect the transfer to the FCA and our wider package of proposals to provide benefits by reducing consumer detriment arising from unaffordable borrowing, from poor-value credit or services, from conflicts of interest and by reducing risk of detriment from loss of client assets. The primary channel for general benefits from the transfer is expected to be from improvements to compliance from the FCA's enhanced supervision and enforcement powers.
26. EE estimate a subset of the overall benefits, those arising from reductions in observed detriment i.e. where consumers are aware that they have been harmed in some way. They estimate an overall reduction in observable detriment, a transfer from firms to consumers, of between £32m and £118m.
27. This estimate of benefit does not include reductions in unobserved detriment. Examples include consumers suffering harm from paying too much due to ineffective competition in a market, and a consumer suffering detriment from an unaffordable loan they have taken out, not realising that the loan was irresponsibly provided by the lender. The unobserved benefits thus include some economic benefits of addressing market failures, for example, where the payday lending proposals improve affordability of loans for consumers and lead to the provision of loans that better meet their actual preferences.<sup>7</sup> Or, for example, where requiring firms to publish the number of complaints makes it easier for consumers to compare the quality of the products or services, making it easier for them to shop around and switch effectively, thus strengthening competition.

<sup>7</sup> This example assumes that some borrowers have been choosing loans they cannot afford and that these loans do not satisfy their true preferences. This is based on evidence that payday consumers can be swayed in their choices by behavioural biases and an assumption that borrowers – if they were not subject to these biases – would prefer an affordable loan over an unaffordable one.

28. EE expect the change in consumer credit regime to lead to significant market exit among credit brokers, secondary credit brokers (motor and non-motor) and other credit-intermediaries. Exit estimates from the transfer for smaller firms in these segments range from up to 12.5% for motor secondary brokers and up to 27.5% for other secondary brokers. This exit, though material, is expected to be predominantly among firms for which consumer credit is a marginal part of their overall business. Figure 1 presents the upper estimates of the exit due to the change in regime.

**Figure 1 – Upper estimates for market exit due to the transfer by segment**



29. Compliance costs, additional fees and the exit of secondary credit brokers distributing their lending are also expected to drive significant exit among small non-bank lenders. Specifically, EE estimate that 15% to 20% of small non-bank lenders (a segment which includes point of sale lenders) will exit due to the change in regime.
30. With the exception of payday lending, EE do not expect significant reduction in the volume of lending from the transfer. This is because even in segments where they expect a significant number of firms to exit, for example credit intermediaries, this is largely exit by firms that have a marginal business in consumer credit. However, they nonetheless expect a small reduction in lending by retail intermediaries; for example, they expect a reduction in lending by non-motor retail intermediaries of between 3% and 4%.

- 31.** Again with the exception of payday lending, EE expect that broadly there will be little impact on competition in consumer credit markets from the transfer and from the package of policy proposals. The increased regulatory burden is likely to increase barriers to entry, but they expect this to be limited. As suggested by the exit by marginal players in consumer credit among intermediaries and small non-bank lenders, the change of regime may disincentivise entry by firms who would otherwise have considered starting small-scale consumer credit business. However, as the number of firms in these segments is expected to remain high, we do not expect the effects of this barrier to entry on competition to be material.
- 32.** Some costs are expected to be passed through in the credit markets where demand is less elastic (e.g. up to 40bp increase in cost of credit from compliance cost pass through in payday, bricks and mortar lending and home credit, though this estimate does not include the additional costs expected to be passed through from lenders changing their lending strategies). Also, as noted above, some cost pass through is expected from the incremental costs imposed on debt management firms.
- 33.** Overall the impacts on the cost of credit, with the exception of payday where lenders are expected to take some compensating measures to recover some of the lost revenue, are expected to be low and evenly spread across consumers of different income levels. However, given the weaker ability of low-income consumers to absorb increased costs, some of these could lose access to credit.
- 34.** Overall, however, access to credit is not expected to be significantly affected, with the exception of payday lending. Also, the low incremental compliance cost of the transfer is not expected to be sufficient to drive material changes in innovation.

### Direct costs to the FCA

- 35.** We have estimated that the transfer will lead us to incur up to about £110m in one-off and ongoing costs in the period leading to April 2016 and about £32m per year afterwards in ongoing costs.<sup>8</sup> These costs 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.
- 36.** As fees are a significant part of the incremental compliance costs firms will face, and some cost pass-through to consumers is expected in certain segments (home credit, debt management, non-bank lenders, and online payday), part of the cost of these fees will likely be borne by consumers through slightly increased costs. However, EE do not expect the compliance cost (including fees) pass-through to be very significant, though as noted above, some lower-income consumers may not be able to absorb the increased costs and could lose access to credit.
- 37.** In the CBA, EE estimate that firms will incur additional fees relative to what they previously paid to the OFT. These are £14m to £22m more from interim permission fees, £25m to £46m more from authorisation fees and about £18m to £26m more in annual fees.

<sup>8</sup> 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.

38. When annual fees that firms will in fact pay to the FCA are calculated (unlike the fees estimates above these are not incremental since they do not include the savings firms make from not paying fees to the OFT), EE estimates that firms will pay between £26m and £35m in annual fees, consistent with our estimate of £32m for the ongoing costs we expect to incur.

### Compliance costs on firms

39. The transfer and the policies proposed are expected to lead to increases in cost on the FCA (direct costs) and increased compliance costs on firms:
- excluding fees, one-off costs on consumer credit firms are estimated at between £56m and £105m, £4m to £6m of which is expected in the interim regime and £53m to £99m is expected in the post-interim (steady state) regime; including fees, firms are expected to incur between £92m and £167m in one-off costs.
  - excluding fees annual costs for consumer credit firms of between £18m to £34m are expected in the steady-state regime; if one includes additional costs firms will incur from fees in addition to what they paid to the OFT annual costs estimates rise to between £35m and £60m;
  - to put these costs in context, one-off costs including fees are between 0.4% and 0.7% of annual consumer credit turnover, while annual costs including fees are between 0.1% and 0.2% of annual consumer credit turnover.
40. Overall, incremental compliance costs on all firms are low as a proportion of their consumer credit revenues. One-off compliance costs arise largely from firms incurring a cost in adjusting to increased supervision and reporting and from reviewing their systems and processes. Among small firms, one-off costs are also expected from administrative costs of preparing for authorisation and the appointed representative regime where applicable. For small firms, the largest ongoing costs are expected to arise from financial promotions. For large firms, ongoing costs are generally expected to be very low relative to existing levels of expenditure.
41. Table 1 presents the costs of the regime by policy element. Costs are also split by small firms (consumer credit turnover less than £250,000) and large firms (consumer credit turnover above £250,000).

**Table 1 – Compliance costs impacts (from Table 1.1 in EE report)**

Interim	All small firms/£m			All large firms/£m			All firms/£m		
interim administration	3.4	to	5.5	0.4	to	0.6	3.8	to	6.1
total interim one-off costs (excl fees)	3.4	to	5.5	0.4	to	0.6	3.8	to	6.1
interim fees	9.3	to	14.2	1.2	to	1.5	10.5	to	15.7
total interim one-off costs (incl fees)	12.8	to	19.7	1.6	to	2.1	14.3	to	21.8
<b>One-off costs</b>									
Authorisation admin	5.2	to	8.8	1.0	to	1.8	6.2	to	10.6
Approved Persons	4.4	to	7.2	1.7	to	3.9	6.2	to	11.2

<b>Interim</b>	<b>All small firms/£m</b>			<b>All large firms/£m</b>			<b>All firms/£m</b>		
High-level Principles and Conduct Standards	1.6	to	2.5	0.1	to	1.0	1.7	to	3.6
Supervision and Reporting	6.9	to	10.4	3.2	to	8.3	10.1	to	18.6
Complaints and Redress	0.1	to	0.3	0.0	to	7.1	0.1	to	7.5
Financial Promotions	3.8	to	6.5	0.6	to	1.5	4.4	to	8.0
Appointed Representative Regime	7.4	to	10.0	0.1	to	0.1	7.5	to	10.1
Payday Lending Specific Policies	0.1	to	0.2	1.2	to	1.7	1.4	to	1.9
Debt Management Specific Policies	0.0	to	0.0	0.4	to	1.7	0.4	to	1.7
Retail conduct review	6.2	to	10.0	8.2	to	15.5	14.5	to	25.5
<b>Total post-interim one-off costs (excl fees)</b>	<b>35.8</b>	<b>to</b>	<b>56.0</b>	<b>16.6</b>	<b>to</b>	<b>42.7</b>	<b>52.5</b>	<b>to</b>	<b>98.6</b>
Authorisation fee	17.4	to	26.6	8.1	to	19.6	25.4	to	46.2
<b>Total post-interim one-off costs (incl fees)</b>	<b>53.2</b>	<b>to</b>	<b>82.6</b>	<b>24.7</b>	<b>to</b>	<b>62.3</b>	<b>77.9</b>	<b>to</b>	<b>144.9</b>
<b>Total one-off costs (incl interim costs and fees)</b>	<b>65.9</b>	<b>to</b>	<b>102.3</b>	<b>26.3</b>	<b>to</b>	<b>64.4</b>	<b>92.2</b>	<b>to</b>	<b>166.7</b>
<b>On-going costs</b>									
Approved Persons	0.5	to	0.8	0.2	to	0.5	0.7	to	1.3
High-level Principles and Conduct Standards	0.1	to	0.3	0.1	to	0.1	0.2	to	0.4
Supervision and Reporting	1.9	to	3.3	0.3	to	1.1	2.3	to	4.3
Complaints and Redress	0.1	to	0.2	0.0	to	1.8	0.1	to	2.0
Financial Promotions	3.3	to	6.5	0.4	to	2.9	3.6	to	9.4
Appointed Representative Regime	9.6	to	12.9	0.1	to	0.2	9.7	to	13.1
PayDay Lending Specific Policies	0.0	to	0.0	0.8	to	0.9	0.8	to	1.0
Debt Management Specific Policies	0.0	to	0.0	0.4	to	2.0	0.4	to	2.0
<b>Total ongoing costs (excl fees)</b>	<b>15.4</b>		<b>23.9</b>	<b>2.2</b>	<b>to</b>	<b>9.5</b>	<b>17.7</b>	<b>to</b>	<b>33.5</b>
Annual fees	7.6	to	11.9	9.9	to	14.4	17.5	to	26.3
<b>Total ongoing costs (incl fees)</b>	<b>23.0</b>	<b>to</b>	<b>35.9</b>	<b>12.1</b>	<b>to</b>	<b>23.9</b>	<b>35.1</b>	<b>to</b>	<b>59.8</b>

42. To put these costs in context and show how they differ by different segments, Figures 2 and 3 below present EE's upper estimates for the one-off and ongoing costs, excluding fees, as a proportion of consumer credit turnover.

Figure 2 - One-off compliance costs excluding fees, % of consumer credit turnover

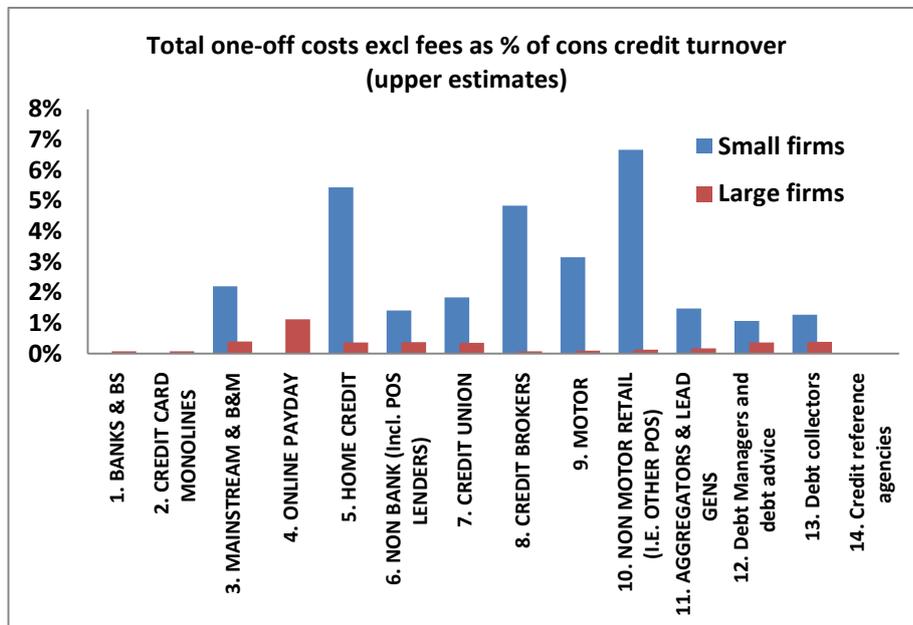
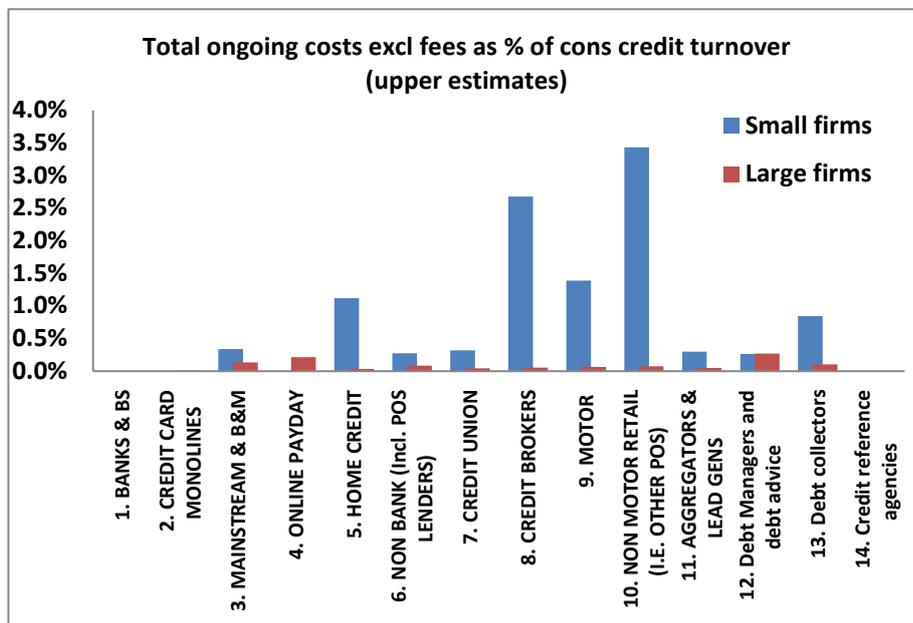


Figure 3 – Ongoing compliance costs excluding fees, % of consumer credit turnover



**Second charge loans**

43. 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. The Government has decided that these loans should sit within the consumer credit regulatory regime from April 2014. Now that the negotiations of the mortgage directive are coming to a close, the Government and the FCA are considering the longer-term regulatory treatment of second charge loans. See Chapter 10 for more information.

44. Second charge lenders have been included in the population of firms analysed by EE, so the incremental costs on these firms are included in the aggregate compliance cost estimates. We would also expect benefits similar to those for similar segments of the consumer credit regime.
45. 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, updating the estimate we presented in the CBA in CP13/7. As in CP13/7, we have 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, excluding fees, for second charge mortgage lenders at between 1.4% and 4.9% of turnover and on-going costs at about 1.5% of turnover.
46. To estimate the 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 £1.1m and £3.7m and estimate ongoing costs (excluding fees) of about £1.1m per year.
47. Finally, these cost estimates should be considered slight over-estimates in that, as set out in chapter 10, we are proposing not to apply the reporting requirements to second charge lenders.
- Exempt Professional firms**
48. Where a Designated Professional Body (DPB) allows consumer credit activities within the scope of their DPB and where members of the DPB carry on consumer credit activities that meet certain conditions (see Chapter 3), these members will be able to carry on 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.
49. In addition, insolvency practitioners whose activities are limited solely to certain specified matters will be exempt.
50. Professional firms that do not fulfil these relevant criteria to be exempt will need to be authorised by us if they want to carry out consumer credit activities, unless otherwise exempt. 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 5% and ongoing costs (excluding fees) of about 2.7% of consumer credit turnover.<sup>9</sup>

**Q27: Do you agree with the costs and benefits identified?**

<sup>9</sup> As some of these firms, those acting under a group licence, were not included in the population of firms analysed by Critical or EE, costs on these firms have not been included in EE's aggregate cost estimates.

# Annex 6

## Equality impact assessment

### Equality Impact Assessment

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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 gender reassignment).
2. We are also required to have due regard to the need to eliminate discrimination and advance equality of opportunity when carrying out our activities.
3. In FSA CP13/7, we published the results of our initial equality impact assessment (EIA) of our proposals in that paper. This annex sets out the feedback we received. We are grateful to those respondents that provided data with their responses or pointed us in the direction of relevant research reports.
4. We have also revisited and updated our initial EIA to take account of the detailed proposals in this paper and have identified the following additional positive impacts on the protected groups:
  - We propose introducing capital requirements for some large not-for-profit debt advice bodies so that consumers (including protected groups) will still be able to receive redress in the event of a firm failure.
  - We are proposing to amend our original proposals so that some large not-for-profit debt advice bodies would be required to have a director or senior manager approved to carry out the 'client asset operational oversight' function. This would mean such firms would need to appoint an individual whose role it is to ensure the firm is complying with the relevant client assets requirements. This additional protection could lead to positive outcomes for all protected groups especially given that protected groups are disproportionately vulnerable to consumer detriment.
  - We propose that not-for-profit debt advice bodies (who provide a valuable service for consumers including the protected groups who are disproportionately vulnerable to consumer detriment) should be covered by the FOS Compulsory Jurisdiction which would mean all consumers using these bodies would have the right of recourse to FOS in the event of a dispute.

We propose a package of measures we propose to put in place for the high-cost short-term credit market. These have two main aims:

- To ensure that firms only lend to borrowers who can afford it – the caps on rollovers and CPAs should help by making it difficult for businesses to base their models on unaffordable

borrowing and reduce the incentive to lend to borrowers who cannot afford the loan.

- To increase borrowers' awareness of the costs and risks of borrowing unaffordably and ways to get help if they have financial difficulties.
5. Overall consumers, including the protected groups who are disproportionately vulnerable to consumer detriment, will benefit from our proposals. Europe Economics expect a material reduction in detriment to consumers of between 27% and 55%<sup>1</sup>. However, these benefits only capture part of the overall benefit to high-cost short-term credit consumers. In particular, the substantive benefits we expect from reducing irresponsible lending are largely excluded from these estimates for two reasons. The estimates are based on reductions in detriment related to consumer complaints. Because consumers often do not attribute problems with an irresponsible loan to the lender and complain, and because the group of consumers most likely to suffer from unaffordable borrowing are also least likely to complain, this may mean the benefits are under-estimated.
  6. Consumers, including the protected groups, will benefit in a range of ways from our proposals. Specifically, they will benefit from borrowing more affordably; better treatment when encountering payment difficulties, and choosing loans that better meet their needs/preferences. In reaching our conclusion that the proposed measures will substantially increase consumer protection overall, we have taken into account ways in which some consumers may suffer from unintended consequences, such as detriment from consumers not being able to roll over their loan more than twice where it is affordable for them to do so or detriment where consumers are prevented from borrowing who, on a reasonable assessment of affordability, cannot afford to repay the loan but who then face worse outcomes as a result. Overall, in our view, the consumer benefit substantially exceeds any consumer harm. Also, given that many of the borrowers that benefit will do so to a greater extent than those who experience harm will suffer, we strongly believe that our proposals should benefit consumers (including the protected groups) overall, which advances our consumer protection objective.
  7. This conclusion also reflects our strong view that regulating lenders so that they target borrowers who can afford to repay the loan is the only possible sustainable outcome for the sector and consumers.
  8. Europe Economics were unable to identify how different consumer types, including protected groups, would be affected by our proposed package of measures. Though it is likely that those with the worst credit history may be faced with reduced access.
  9. **As a result, we would particularly welcome any views, evidence or information respondents may have on any equality and diversity issues they believe arise from these proposals and the proposals in the rest of this paper.**

**Q28: Do you agree with our assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?**

<sup>1</sup> Europe Economics' estimates are based on the National Audit Office's (NAO) estimate of detriment in consumer credit NAO (2012), 'Office of Fair Trading: Regulating Consumer Credit, Technical Paper', [http://www.nao.org.uk/wp-content/uploads/2012/12/1213685\\_tech\\_paper.pdf](http://www.nao.org.uk/wp-content/uploads/2012/12/1213685_tech_paper.pdf)

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### Feedback on initial assessments

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10. In CP13/7, we asked:

**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?**

11. The majority of respondents to this question either had no comments or agreed with our initial assessment. A number of respondents raised specific issues which we discuss below. Others did not comment on the impact of our proposals on the protected groups as a whole but instead highlighted particular issues affecting some of the protected groups which we summarise below.

### Next steps

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12. One respondent suggested we should assess the impact of our proposals on protected groups within 12 months of the new regime taking effect. Another thought it would be helpful to establish a baseline and monitor the impact of the new regime on protected groups over the next 20 years.
13. The Financial Inclusion Centre considered we should focus on gathering information to understand which groups of consumers are being actively targeted by high cost credit or high risk lenders. Zero-credit thought we should also consider the social and financial exclusion imposed on people struggling to manage debt.

#### Our response:

As described in Chapter 13, we propose to undertake a post-implementation review of the transfer after 1 April 2014 and we will consider these suggestions alongside our planning for that work.

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### Positive impacts

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14. Most respondents agreed with our assessment that protected groups are disproportionately vulnerable to the risks in the consumer credit market. One respondent considered there was insufficient evidence to support this statement. A few respondents commented that protected groups were more likely to be financially excluded.
15. The Money Advice Trust also agreed that strengthened consumer protections would positively impact on the protected groups. They added that some vulnerable groups (for example, those receiving benefits, the unemployed, lone parents and those with mental health problems) were more likely to fall into debt or feel the effects of debt enforcement activity than other sections of the population.

## Age

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16. The Financial Inclusion Centre commented that whilst we had not identified any age related impacts, younger consumers (in particular, those under 25) are vulnerable to growing detriment in the payday lending market.
17. Zero-credit pointed to research that showed debt levels and demand for free debt advice is increasing amongst the elderly.

## Gender

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18. One respondent stated that, based on their own experience, borrowers of home credit were mainly women and single parents, the latter having a much higher risk of being in arrears than two-parent families. One respondent offered to share limited evidence of possible gender bias in creditor actions. Zero-credit pointed to research indicating there has been an increase in women seeking debt advice.

## Disability

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19. Three respondents supported our proposal to turn parts of the OFT's Mental Capacity Guidance into FCA guidance. Money Advice Scotland requested that we consider also incorporating the OFT's Debt Collection Guidance into our guidance. Scope also called for the development of specific rules or guidance to protect the disabled and to ensure they have access to affordable credit. In particular, they suggested requirements on firms to:
  - make lending decisions for disabled customers based on facts about their steady and non-steady income streams;
  - release data about affordability checks and the state benefits received by those refused credit;
  - offer flexible debt repayment schemes;
  - simplify their pricing schemes/ not use teaser rates;
  - use a standard template when calculating and providing information about interest rates; and
  - ensure they do not advertise products in a deliberately misleading way or withhold information on extra charges.

**Our response:**

In Chapter 5, we set out the conduct standards we plan to introduce which include requirements to ensure communications to consumers are clear, fair and not misleading. We also confirm that we propose to take forward parts of the OFT's Mental Capacity Guidance and the OFT's Debt Collection Guidance.

We will monitor how firms respond to the rules we introduce and we will strengthen our policy by introducing new or tougher rules if we decide that more protection is needed to stop consumers suffering due to unscrupulous or inappropriate behaviours in the consumer credit market.

**Race**

20. One respondent offered to share limited evidence of possible race bias in creditor actions. Another pointed to research suggesting ethnic minorities had reported a higher prevalence of creditor sanctions both before and after entering a debt solution.
21. One respondent considered it should be for firms to decide whether to provide customer facing material in other languages.

**Our response:**

We were not proposing that firms must provide customer facing materials in other languages. Rather, we were proposing that we would develop our rules and guidance so they do not prevent firms from doing so in order to meet their equality obligations. 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/>.

**Impact on the availability of credit for protected groups**

22. The British Retail Consortium considered that protected and non-protected groups would generally be affected to the same extent by any reduction in the availability of credit. The BBA commented that a reduction in the availability of point of sale credit might negatively impact the elderly, disabled or those who are either pregnant or on maternity leave as these groups choose to use point of sale credit on the basis of its accessibility due for instance to lack of mobility.

**Our response:**

We further discuss the availability of credit and the impacts of the transfer in Annex 5 which contains a cost benefit analysis of our proposals.

# Annex 7

## FCA Compatibility statement

### Compatibility with the general duties of the Financial Conduct Authority

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1. This annex explains how the FCA satisfies the requirements set out in section 138I of the Financial Services and Markets Act (FSMA). The FCA is required under the Act to explain 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.
2. This annex also 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

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3. The proposals set out in this consultation primarily advance the FCA's operational objective of 'securing an appropriate degree of protection for consumers.'
4. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets<sup>1</sup> function well. In addition to our high-level conduct of business rules, we have designed specific rules that are intended to ensure that firms operating in the consumer credit market are fit to do so, and that customers are provided with an appropriate degree of protection.
5. We have designed proposals that take into account the structure of the consumer credit markets, ensuring they do not impact on market practices unless these are harmful to consumers. For example, having considered representations made during our consultation, we are now proposing to allow appointed representatives carrying on debt collection to enter into multi-principal arrangements. We are persuaded that there is a significant risk that not to do so could potentially have an adverse impact on the operation of the sector in a way that could harm the interests of those being pursued for multiple debts in particular.
6. We consider that these proposals advance the FCA's operational objective of securing an appropriate degree of protection for consumers. We believe we will deliver better outcomes for consumers through the key features of our proposals:
  - **Tools for better regulation of the consumer credit markets:** authorised firms will be required to report certain key pieces of information to us. This will enable us to gain a useful picture of the consumer credit market and focus our resources on the sectors, issues and

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<sup>1</sup> "relevant markets" are defined by s.1F FSMA

risks that are of greatest significance. Having access to regular information about firms will support our proactive supervision of the riskiest firms.

- **Improving firm communications with consumers:** we propose to require financial promotions and communications from firms that provide lending, broking, debt counselling, debt adjusting, the new peer-to-peer activity and hiring activities to adhere to our clear, fair and not misleading rule (reflecting PRIN 7).
- **Conduct rules and guidance<sup>2</sup>:** the current consumer credit regime comprises the standards set out in the CCA and its secondary legislation as well as OFT guidance. We will be carrying across many of these standards into our own rules and guidance, which will help to protect consumers and help firms transition to the new regime.
- **Setting clear standards for assessing affordability for all types of lending<sup>3</sup>:** making it a rule that firms must assess the potential that granting a loan could adversely affect a consumer's financial situation and ability to make repayments over the whole life of the loan.
- **A more intensive supervisory regime** for larger and riskier firms, including business model and strategy analysis.

We also have proposals for specific sectors for improving consumer protection:

### Improving outcomes for consumers using high-cost short-term credit

- Requiring high-cost short-term credit providers to introduce a risk warning on their loan adverts, provide information on free debt advice before a loan is rolled over, limit the number of rollovers of a loan agreement to two and the number of unsuccessful attempts on the use of continuous payment authorities to pay off a loan to two and only for full payment to avoid lenders scraping consumers' accounts. Chapter 6 gives full details.

### Promoting responsible management of debt management firms

- Prudential standards for certain debt management and not-for-profit debt advice bodies in order to minimise the risk of harm to consumers by helping to ensure that firms responsibly manage their risks.
- All debt management firms and not-for-profit-debt advice bodies that have held, or will hold, client money will be subject to our client assets requirements, with additional client asset requirements for larger firms. Larger firms are those that hold, or will hold, over £1 million in client money at any one time.

<sup>2</sup> The FCA's competition duty under section 1B(4) FSMA does not apply to the extent an FCA rule or guidance is the same as (or substantially the same as) or has the same effect (or substantially the same effect) as provisions of the Consumer Credit Act 1974, its secondary legislation or OFT Guidance or certain notices. Article 61 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013.

<sup>3</sup> See above footnote.

### **New protections for borrowers using peer-to-peer platforms**

- Rules to ensure that borrowers using peer-to-peer platforms will have an appropriate degree of protection, setting out proposed rules covering financial promotions, adequate explanations, creditworthiness assessments, arrears and debt collection (including notices for arrears and default) and credit information services including credit repair.

### **The FCA's regulatory principles**

7. 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 our proposals demonstrate such regard for each of the regulatory principles.

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

8. We propose to take a differentiated approach to firms according to the risk they pose consumers and target our resources at the key risks. For example, we propose to target our resources at higher-risk activities – such as high-cost short-term credit and debt management. In the light of feedback to FSA CP13/7, we have revised our proposals to include vehicle leasing within the lower-risk limited permission regime. This will allow our resources to be allocated in the most efficient way.

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

9. A key principle in designing the regime is proportionality. This is reflected in a number of the key features of our regime design, for example, firms carrying on lower-risk activities will be subject to reduced regulatory requirements. We are proposing a reporting regime that targets key information from the riskiest firms and activities, whilst ensuring we have basic information for supervision of lower-risk firms.
10. Our proposals for high-cost short-term credit will have a significant impact on firms in that market. We expect, however, this impact to be largely a result of firms lending more responsibly and that this will lead to substantial overall benefits for consumers. Also, the CBA estimates that the change in regime will bring about a material reduction in 'observed' consumer detriment (i.e. detriment consumers are aware of, attribute to firms and may complain about) of between 27% and 55%. Taken together, we believe that the burdens and restrictions, therefore, should be proportionate to the expected benefits.
11. We are making a number of proposals that will impact the debt management sector, but we have tailored our approach with a view to ensuring burdens are proportionate to the size of firm and the risks, for example, whilst we propose that all debt management firms will be required to adhere to standards for protecting client money, only firms holding over £1 million of client money at any one time will be subject to the strictest requirements.

#### **The general principle that consumers should take responsibility for their decisions**

12. Our proposals will ensure that consumers are treated in a fair way while still being responsible for their own decisions. Firms are required to provide consumers with adequate pre-contractual information and other risk warnings to help inform their decisions whether to enter into a regulated credit agreement. We are proposing a risk warning on high-cost short-term credit advertising designed to empower consumers to consider the risks carefully before taking out this type of loan. We are also requiring firms, such as high-cost short-term lenders and profit seeking debt advisors, to provide more information about sources of free and independent debt advice to help consumers deal with their debts and seek resolution of indebtedness problems.

**The responsibilities of senior management of persons subject to requirements imposed by or under FSMA including those affecting consumers, in relation to compliance with those requirements**

13. We will apply our approved persons requirements, so that where an individual wants to carry out a particular activity for a firm that we call a ‘controlled function’, before they do so, they must apply to become an ‘approved person’. We have taken a proportionate approach to this and do not propose to apply the customer function to consumer credit firms, while limited permission firms will, generally, only be required to have one responsible person approved for the apportionment and oversight function.

**The desirability where appropriate of each regulator exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons subject to requirements imposed by or under FSMA**

14. We propose to tailor our regime to the businesses that firms carry on, reflecting the difference in their business models. For example, we are proposing that all regulated debt advice should be subject to conduct of business rules largely derived from the OFT’s Debt Management Guidance. However, we will take a proportionate approach to regulating those firms and other bodies that provide different types of regulated debt advice, taking account of the nature, scale and complexity of the firms’ debt advice activities.
15. In order to reduce unnecessary burdens in the transfer of responsibility to the FCA, the financial promotion proposals are heavily based on the existing consumer credit secondary legislation and the OFT’s guidance relevant to lending, credit broking and debt management. We propose to keep the current approach similar for second charge lending so that to the extent a financial promotion is about qualifying credit it will remain covered by the current MCOB rules and second charge lenders that do not also provide regulated mortgage contracts will be faced with familiar rules.

**The desirability of publishing information relating to persons**

16. Whilst we have the power to publish information relating to investigations into firms and individuals, EG 6 states that we will not normally make investigations, or any of our findings or conclusions public except in exceptional circumstances.

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

17. 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.

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

18. Our proposals have regard to the desirability of sustainable growth in the medium and long term. We do not expect our proposals to have a material impact on the provision of consumer credit: our CBA suggests that market exit by firms will be predominantly amongst those who are doing a small amount of consumer credit activity.
19. Although we expect a material reduction in high-cost short-term credit provision as a result of our proposals, this amounts to a very small impact on overall consumer credit lending. Also, we expect the impacts on lending to reflect overall an adjustment to more sustainable credit, which should, in principle, benefit growth in the medium to long term.

### Action intended to minimise the extent to which it is possible for a business carried on to be used for a purpose connected with financial crime

20. The FCA satisfied its duty under section 1B(5)(b) in relation to financial crime in FSA CP13/7 and the instrument made by its Board in September (see Appendix 1) which requires all firms to actively take measures to counter the risk that the firm might be used to further financial crime (SYSC 6.1.1). The instrument also requires firms subject to the Money Laundering Regulations 2007 to take further measures, including appointing a Money Laundering Reporting Officer.

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

21. In preparing the proposals as set out in this consultation, we consider we have met the FCA's duty under s.1B(4) FSMA<sup>4</sup>. 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.
22. 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.

### Reporting

23. Through analysis of data reported by firms, we hope to identify geographical or demographic indicators of detrimental consumer outcomes, particularly in the high-cost short-term credit sector, in order to identify whether specific areas or segments of the population (such as vulnerable consumers with limited access to credit) are only being sold uncompetitive products. We will also be able to use data to consider how a firm performs in relation to the level of service provided to customers i.e. to identify firms with artificially low fees or rates but high numbers of complaints. We will consider the mechanisms firms use to generate income to ensure these are fair. Also, by collecting information on the range of fees being charged, or level of interest rates applied in each sector, we will gain an insight into how competitive these sectors are, and an indication of whether firms are using price as a method for differentiating their products from their competitors.
24. Complaints reporting by consumer credit firms is an important indicator of whether firms are treating their customers fairly and whether firms are competing to provide the quality expected by consumers. This requirement brings these firms into line with existing FCA-authorized firms that already report complaints on some consumer credit activities. However we have taken a proportionate approach and firms with limited permissions will report minimal complaints data. We therefore consider that the requirement is needed to enable us to meet our consumer protection objective and is compatible with the duty to promote effective competition in the interests of consumers.

<sup>4</sup> The duty to promote effective competition in the interests of consumers does not apply to rules and guidance that are the same or have substantially the same effect as CCA provisions or OFT guidance (article 61(2) SI 2013/1881)

**Financial promotions**

25. We are proposing to apply the principle to all firms that their communications with consumers and their financial promotions are clear, fair and not mis-leading. This supports consumers in making informed choices and helps them to apply competitive pressures.

**Debt management**

26. We are proposing new prudential requirements for debt management firms and not-for-profit debt advice bodies to improve the way they manage their risks and new rules governing how firms must protect their clients' money. It is very difficult to formulate regulatory interventions that would empower consumers to apply competitive pressure on firms that would incentivise better prudential and client money management, so our rules reflect the need for regulatory intervention where there is no means of addressing the problem through promoting competition.
27. In terms of our prudential requirements, our fixed minimum amount is £5,000. We believe that a larger minimum than this could result in a barrier to entry and constrain competition in the market.
28. Along with a fixed minimum, our proposals include a variable, volume-based requirement to ensure that firms hold sufficient capital as they become larger and pose greater risks to consumers. Our measure aims to capture the following risks:
- the likelihood of firms holding large amounts of client money at any point in time
  - the length of time it will take to wind down a firm
  - the complexity of the firm including its size and number of customers
29. The volume-based measure we chose that captures these risks is 'relevant debts under management'. During our analysis we also looked into alternative volume-based measures to ensure the measure we chose was the most appropriate at addressing the risks that these firms pose to consumers. One alternative measure that we considered was for firms to use their relevant fixed expenditure (fixed overhead requirement). However, we found that the impact of this measure would disproportionately affect smaller firms and potentially discourage new firms to enter the market.
30. We are proposing a number of new rules for managing client money, with additional rules for the largest firms. In the absence of incentives to improve client money protections, our rules provide a minimum standard that firms must adopt, thus ensuring that whilst consumers may not be focused on client asset protection when selecting a debt management provider, they can be confident that firms are not competing on price at the expense of good quality client money protections. Our proposals may eliminate incentives to firms to reduce the quality of non-observable elements of their service to improve the quality and/ or price of observable elements of their service. In this sense, our proposals may improve the quality of competition. We have decided to propose a core set of rules for all debt management firms, regardless of size, because we consider that client money rules work as a package of minimum requirements, in order to provide adequate protection.
31. We are proposing some new rules that are derived from the Debt Management Protocol. The proposal that debt management firms signpost consumers to the availability of free sources of debt advice when they first communicate with them will help promote informed choices amongst consumers and empower them to apply competitive pressures to firms (CONC 2.6.2). Our proposal that a firm must recover its set-up costs in a way that does not prevent significant repayments being made to a customer's creditors from the first month of a debt management

plan and every subsequent month during the course of the plan, is, in part, a response to the lack of pressure that consumers are able to exert in relation to debt management firm fee structures (CONC 8.7.2).

#### **High-cost short-term credit**

- 32.** In high-cost short term credit, we are proposing robust rules to ensure lenders target borrowers who can afford to repay. From our CBA, we expect these will lead to significant exit by firms and a material reduction in lending. Although impacts of this kind are not typically desirable from a competition perspective, we believe these rules are necessary to advance our consumer protection objective, as we explain in detail in Chapter 6. Our conclusion here is informed by consideration of alternative, more pro-competitive proposals (e.g. increasing transparency for consumers) that we concluded would not be sufficient to reduce detriment. We also note that firms competing to lend to borrowers who probably cannot afford to repay the loans is not the competition in the interests of consumers that we are tasked to promote.
- 33.** In addition, we expect the material impacts of the high-cost short-term credit rules to reflect the market adjusting to target borrowers who can afford to repay. As additional barriers to entry and innovation should be limited, we would expect firms to innovate, firms to enter the market and ultimately, the market to gravitate to a healthier state with competition focused on the provision of affordable loans.

#### **Peer-to-peer lending**

- 34.** The only new regulated credit activity is that of 'operating an electronic platform in relation to lending', the activity undertaken by peer-to-peer lending platforms. Our proposed approach to regulating the conduct of peer-to-peer platforms in their dealings with borrowers is to provide for what we consider to be appropriate and proportionate protections for borrowers while not constraining the growth of a new and innovative credit market.
- 35.** This market is growing and it is expected to continue to do so and increasingly meet a larger proportion of the total demand for credit in the UK. In proposing our regulatory requirements we have had particular regard to the need not to raise undue barriers to new market entrants. The growth of this market also increasingly exerts competitive pressure on other related markets, including on credit markets such as those for consumer loans.
- 36.** We recognise that each peer-to-peer platform differs from others, so while some of our proposed rules have general application to all peer-to-peer platforms, we are also proposing to make some rules that apply in a manner proportionate to the particular business model affected, and the specific risks to which customers will be exposed. For example, we are proposing to apply specific rules to any platforms that facilitate borrowers obtaining high-cost short-term credit.
- 37.** The rationale behind our proposals for rules to be applied to peer-to-peer platforms is set out in more detail in Annex 1 of this consultation paper (in our response to question 19 of FSA CP 13/7).
- 38.** More generally, the overall impact of the package of proposals should 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 penalising firms that are competing on (or would compete) on features that consumers do not truly value) should strengthen competition.

# Annex 8

## The impact of our proposals on mutual societies

### Introduction

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1. The proposals set out in this Consultation Paper affect a wide range of different firms in the consumer credit market, including mutual societies. The draft rules can be found in Appendix 2 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:
  - Our 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 persons<sup>1</sup>: and
  - If so, details of the difference.

### Which of our proposals will affect mutual societies?

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3. The extent to which our proposed rules will have an impact on mutual societies will depend on which credit-related regulated activities they carry on (if any). Our proposed rules relating to conduct standards, regulatory reporting and approved persons may affect mutual societies.
4. We do not expect our proposals for high-cost short-term credit to affect mutual societies, given our definition of high-cost short-term credit. Similarly, we do not anticipate that mutual societies would fall within the scope of our proposed specific prudential requirements or detailed client money requirements for debt management firms and large not-for-profit debt advice bodies. Nor do we anticipate that our proposed requirements with respect to peer-to-peer lending activity and product sales data reporting will affect mutual societies.

### How do our proposals affect different types of firms?

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#### Building societies

5. Section 5 of the Building Societies Act 1986 provides that a building society may be established only if its purpose or principal purpose is making loans that are secured on residential property and are funded substantially by its members. The 1986 Act and then the Building Societies Act 1997 removed many of the historical restrictions on the lending power of a building society, and now the existence and scope of a building society's power to make secured or unsecured loans is defined by its memorandum.

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

6. We note that, under article 60E of the Regulated Activities Order and rules made by the FCA under it in the Appendix to the Consumer Credit sourcebook, certain credit agreements relating to the purchase of land will be exempt agreements (and therefore not regulated credit agreements for the purposes of the regulated activity in article 60B of the Regulated Activities Order) if the lender is a building society with permission to accept deposits. A credit agreement will also be an exempt agreement if it is a regulated mortgage contract.
7. We still believe that there are only 6 building societies currently active in the consumer credit market, although others may have a consumer credit licence and not be using it. Our CBA analysis in Annex 5 suggests that the impact on building societies will be very small, since they are already FCA regulated.

#### ***Approved persons***

8. A regulated firm must take reasonable care to ensure that no person performs certain functions specified by the appropriate regulator (known as controlled functions) unless they have been given approval.
9. Building societies are PRA-authorised persons and are already regulated by the PRA and us in relation to their non-consumer credit regulated activity. Our proposed rules relating to FCA governing functions would not affect PRA authorised persons (to whom the PRA governing functions already apply). The FCA required functions do, however, apply to PRA authorised persons. The impact of our proposals would be that FCA required functions cover regulated consumer credit activities. So, for example, the director or senior manager who is appointed as the compliance officer in relation to consumer credit activity under the systems and controls rules would require approval to perform the compliance oversight function. This will not significantly differ from the impact on other authorised persons.

#### ***Reporting***

10. We propose that firms will be required to report certain pieces of data to us, with the frequency of the reporting being dependent upon the size of the firm - firms generating more than £5 million in revenue per year from consumer credit business reporting every six months, and smaller firms only reporting annually.
11. As building societies are already regulated by us, we do not propose collecting any additional information from them in relation to their financial information. We will collect information on the value and amount of loans, arrears and interest rates from building societies that have permission to enter into regulated credit agreements as a lender.<sup>2</sup> We also propose to require firms to report complaints about credit-related regulated activities. Building societies already have to report complaints about loans. We also propose to require that larger firms that carry on only credit-related regulated activities should publish complaints data where they have received 500 complaints or more in a six month period and smaller firms that carry on only credit-related regulated activities should publish their complaints data where they have received 1000 or more complaints in a twelve month period. Building societies already have to publish complaints data where they have received 500 complaints or more in a six month period. We do not consider that the application of these proposed reporting rules will have a significantly different impact on building societies than on other authorised persons.

<sup>2</sup> Or building societies who exercise lender's rights and duties under a regulated credit agreement.

**Conduct standards**

12. We are proposing conduct rules and guidance including:
- rules and guidance which reflect provisions of the CCA and its secondary legislation that have been repealed
  - OFT guidance, that we will carry across as either rules or guidance
  - some material from existing industry codes
13. The proposed rules and guidance reflect the requirements and guidance of the current regime and we do not consider that there is any reason why building societies will be impacted significantly differently from other consumer credit firms in complying with the FCA's rules and guidance.

**Financial Promotions**

14. We propose that building societies will be subject to our financial promotions regime and be required to adhere to the high-level principle that a communication or financial promotion is clear, fair and not misleading. This requirement is in addition to the requirements found in PRIN and the Consumer Protection from Unfair Trading Regulations. We consider that the proposed rules will have the same impact on building societies as they will do on other consumer credit firms carrying on other regulated activities.

**Credit Unions**

15. Credit unions in Great Britain are registered under the Industrial and Provident Act 1965 and in accordance with the Credit Unions Act 1979. Credit Unions in Northern Ireland are registered under the Industrial and Provident Act (Northern Ireland) 1969 and in accordance with the Credit Unions (Northern Ireland) Order 1985.
16. The FCA is the registering authority for credit unions in Great Britain. Credit Unions in Northern Ireland are currently still registered under the Department of Enterprise, Trade and Investment Northern Ireland (DETI).
17. A principal purpose of credit unions' business is the accumulation of its members' savings to provide a fund out of which loans are provided for the benefit of members.
18. 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 (or such lesser amount as may be specified, in excess of a member's shareholding).
19. 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.
20. 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 26.8%. The substance of this exemption will be carried forwards into the new FSMA regime, but the maximum rate of the total charge for credit will be increased to 42.6%.

21. If the only consumer credit activity a credit union carries on is making loans to its members under borrower-lender agreements within the exemption, it will not need permission for lending. Also, activities carried on by a credit union are not credit-broking, debt adjusting, debt counselling, debt administration or debt collecting if it is the lender under the credit agreement concerned.
22. Credit unions are already required to be authorised by the PRA and regulated by the PRA and FCA in order to accept deposits and to comply with their rules in relation to their existing FSMA regulated activities.
23. In recognition of their role in their communities and the fact that they are generally run by volunteers, the practice is to apply a proportionate type of supervision to credit unions in comparison to the rest of the FCA firm population. They have relatively modest regulatory requirements. Our CBA analysis in Chapter 6 suggests the impact on credit unions will be fairly contained, since they are already FCA regulated.

#### ***Approved persons***

24. Credit unions are already authorised by the PRA and regulated by the PRA and FCA. FCA governing functions do not apply to PRA authorised persons. In so far as the extension of our systems and controls rules to cover consumer credit activity affects the scope of the FCA controlled functions for credit unions (the money laundering reporting function and, if applicable, the significant management function), we do not consider that there will be a significantly different impact on credit unions than on other small firms who are also already authorised persons.

#### ***Reporting***

25. In general, the reporting proposals will apply to credit unions in respect of their regulated consumer credit activity. However, we expect much of their lending activity is likely to fall under the exemption referred to above for borrower-lender agreements where the rate of the total charge for credit does not exceed 42.6%. The impact is therefore likely to be smaller on credit unions than on other lenders. Where they carry on regulated consumer credit activity, we consider that the impact will be similar to other smaller firms carrying on regulated consumer credit activity.
26. The complaints reporting rules and the complaints data publication rules in the Dispute Resolution: Complaints sourcebook do not apply to a credit union. So, our proposed amendments to these rules will not affect credit unions. Chapter 9 of the Credit Unions New sourcebook (CREDS) sets out rules and guidance for credit unions on completing reports concerning complaints. We propose to consult on consequential changes needed to CREDS 9 in late 2013.

#### ***Conduct standards***

27. We propose that the conduct standards will apply to credit unions' regulated consumer credit activities but because much of their lending activity will fall under the exemption, there will be a more limited impact on credit unions than on other lenders. Where credit unions carry on regulated consumer credit business, we consider that the impact will be similar to other small firms carrying on consumer credit business.

#### ***Financial Promotions***

28. We propose that credit unions will be required to adhere to the high-level principle that a communication or financial promotion is clear, fair and not misleading. This requirement is in addition to the requirements found in PRIN and the CPRs. As much of their lending activity will fall under the exemption, there will be a more limited impact on credit unions than on other

lenders. Where credit unions carry on regulated consumer credit business, we consider that the impact will be similar to other small firms carrying on consumer credit business.

#### **Industrial and provident societies**

- 29.** 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 FCA under FSMA. Depending on the nature of their activities, industrial and provident societies may be subject to either the higher or lower –risk regimes.
- 30.** If they carry on credit-related regulated activity, our proposals for approved persons, reporting, conduct standards and financial promotions would apply to industrial and provident societies in the same way as to other consumer credit firms. They would need to seek approval for certain individuals, put in place processes for reporting the required data and take time to understand and check their compliance with the conduct standards and financial promotions regime. However, we expect the impact on them would be similar to the impact on other small businesses which are not currently regulated by the FCA.

#### **Friendly societies**

- 31.** 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 under FSMA.
- 32.** If they carry on credit-related regulated activity, our proposals for approved persons, reporting, conduct standards and financial promotions would apply to friendly societies in the same way as to other consumer credit firms. Friendly societies who are not currently FCA regulated will need to seek approval for certain individuals, put in place processes for reporting the required data and take time to understand and check their compliance with the conduct standards and financial promotions regime. However, we expect the impact on them would be similar to the impact on other small businesses who are not currently regulated by the FCA.
- 33.** We expect there will be a more limited impact on friendly societies who are currently FCA regulated, which will be similar to other small businesses who are currently FCA regulated.

#### **EEA mutual societies**

- 34.** For these purposes, EEA mutual societies are defined as:
- 1.** A body which is a European Cooperative Society for the purposes of Council Regulation (EC) No 1435/2003 (statute for a European Cooperative Society);
  - 2.** A body which is established as a cooperative under the law of an EEA state as mentioned in that Regulation;
  - 3.** 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.

- 35.** There are currently no UK registered European co-operative societies.
- 36.** We do not expect our proposed rules to result in a different impact on EEA mutual societies than on other authorised persons.