

## Finalised Guidance

# FG 17/1 Guarantor loans: default notices

January 2017

## 1 Introduction

- 1.1 Under section 139A of the Financial Services and Markets Act 2000 (FSMA), the Financial Conduct Authority (FCA) may give guidance that consists of any information and advice that we consider appropriate to matters relating to our functions.
- 1.2 This document constitutes general guidance to consumer credit firms. It concerns our interpretation of the requirement in section 87 of the Consumer Credit Act 1974 (CCA) to serve a default notice before the creditor (or owner) enforces a guarantee or indemnity following breach of a regulated agreement.
- 1.3 The guidance relates to regulated credit agreements and regulated consumer hire agreements under which an individual<sup>1</sup> other than the borrower or hirer provides a guarantee or indemnity (or both). For convenience, we refer to these agreements as 'guarantor loans' and the person providing the guarantee or indemnity as the 'guarantor'.

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<sup>1</sup> As set out in section 189 of the CCA, 'individual' includes a partnership consisting of two or three persons (not all of whom are bodies corporate) and an unincorporated body of persons (which does not consist entirely of bodies corporate and is not a partnership).

- 1.4 In this document, references to 'credit agreement' include a consumer hire agreement (where relevant), and references to 'lender' and 'borrower' include owners and hirers. We use the word 'guarantee' to cover guarantees and indemnities.<sup>2</sup>
- 1.5 We consulted on draft guidance in October 2016 in GC16/7<sup>3</sup>, taking into account comments received on previous draft guidance in GC16/2.<sup>4</sup>
- 1.6 We received 11 responses to this further consultation, from four firms, two trade associations and five consumer organisations. We also received informal feedback from firms and trade bodies at a roundtable meeting held on 17 November 2016.
- 1.7 Respondents were generally supportive of the proposed revised guidance, although there were some suggestions for minor changes to the draft in order to further clarify the legal position and the FCA's view. We have made changes in light of these suggestions. Respondents also took the opportunity to express views generally about guarantor lending issues.
- 1.8 One respondent suggested that any request made of a guarantor should be considered as enforcement. We do not agree. In our view, 'enforcement' has to carry an element of coercion; however, we are further clarifying the distinction between a 'demand' for payment and a 'request' which makes clear that the guarantor is not required to pay.
- 1.9 We are now publishing finalised guidance, taking account of these comments.
- 1.10 We intend to keep the guarantor lending market under review, and may propose changes to our rules or guidance if we consider it appropriate in the future.
- 1.11 All our publications are available to download from [www.fca.org.uk](http://www.fca.org.uk). If you would like to receive this document in an alternative format, please call 020 706 0790 or email: [publications\\_graphics@fca.org.uk](mailto:publications_graphics@fca.org.uk) or write to Editorial and Digital Team, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

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<sup>2</sup> This guidance is concerned only with enforcing a guarantee or indemnity under a guarantor loan, and not enforcement against a borrower.

<sup>3</sup> GC16/7: *Revised proposed guidance on guarantor loans* (October 2016) – [www.fca.org.uk/publication/guidance-consultation/gc16-07.pdf](http://www.fca.org.uk/publication/guidance-consultation/gc16-07.pdf)

<sup>4</sup> GC16/2: *Proposal to issue guidance on the FCA's view of enforcing security under the Consumer Credit Act 1974: Guarantor loans – default notices* (February 2016) – [www.fca.org.uk/publication/guidance-consultation/gc16-02.pdf](http://www.fca.org.uk/publication/guidance-consultation/gc16-02.pdf)

## 2 Guarantor loans – default notices

### The CCA requirements

- 2.1 Section 189 of the CCA defines ‘security’ as including a guarantee or indemnity, and ‘surety’ means the person by whom security is provided or to whom that person’s rights and duties in relation to the security have passed.
- 2.2 Under section 105, any security provided in relation to a regulated agreement must be expressed in writing. Regulations<sup>5</sup> under section 105 define the form and content of that document, including information that must be provided and a prescribed statement of the surety’s rights. The document must be signed by or on behalf of the surety.
- 2.3 Under section 87, following a breach of the agreement, a default notice must be served on the borrower before the lender can enforce the security.
- 2.4 Section 111 requires a copy of the default notice to be served on any guarantor.
- 2.5 The notice must meet the requirements of section 88 and relevant regulations<sup>6</sup>, and must contain specified information, including:
- the nature of the alleged breach of the agreement
  - if the breach can be remedied, what action is required to do so and the date before which that action is to be taken (the date must not be less than 14 days after the date on which the notice is served), and
  - a clear and unambiguous statement of the action the lender intends to take if the breach is not remedied
- 2.6 As noted in GC16/7, we do not consider that ‘enforcement of security’ is limited to obtaining a court judgment. In our view it is clear from the structure of the CCA, and relevant case law, that enforcement can include exercising some forms of ‘self-help’ remedy relating to security if the remedy is sufficiently coercive.

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<sup>5</sup> The Consumer Credit (Guarantees and Indemnities) Regulations 1983, SI 1983/1556.

<sup>6</sup> The Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983, SI 1983/1561.

## Enforcement of guarantees

- 2.7 A guarantee is enforced in the FCA's view if, following breach of the agreement by the borrower:
- the lender *demands* payment by the guarantor, or
  - the lender *takes* payment from the guarantor by using a continuous payment authority (CPA) or direct debit mandate that was previously provided and without at least appropriate prior notification to the guarantor
- 2.8 This is consistent, in our view, with a proper interpretation of section 87, having regard to the purpose of the relevant CCA provisions and case law.
- 2.9 On the other hand, a guarantee is *not* enforced in our view if:
- payment is made *voluntarily* by the guarantor, following notification of the breach by the borrower, and without any element of compulsion, or
  - the lender *requests* payment by the guarantor, but making clear that this is not a demand for payment (and so the communication by the lender to the guarantor does not seek to force or pressurise the guarantor to pay)<sup>7</sup>
- 2.10 While a guarantor may have consented upfront to a facility enabling payments to be taken from his or her account, unlike the borrower, the guarantor does not know when payment may be taken, or for what amount, given that the guarantee will not be used unless the borrower fails to make one or more payments. In the FCA's view, exercise of the CPA or direct debit without appropriate prior notification, would be sufficiently coercive as to constitute enforcement of the security within the meaning of section 87.
- 2.11 On the other hand, we accept that taking payment via CPA or direct debit may not constitute enforcement of the guarantee where the guarantor is pre-notified before the payment is taken. In our view, it would not be sufficiently coercive, as the guarantor would have an opportunity to object or cancel the payment authority.
- 2.12 However, it is important that the notification gives the guarantor a reasonable opportunity to act if he or she wishes to avoid payment being taken.
- 2.13 Specifically, before any payment is taken, we would expect the lender to clearly inform the guarantor:
- that the borrower has breached his or her obligations under the agreement, and the nature and extent of the breach

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<sup>7</sup> Any communication must be clear, fair and not misleading in line with CONC 3.3 in our Consumer Credit sourcebook (CONC). In particular, it must be sufficient for, and presented in a way that is likely to be understood by, the recipient, using plain and intelligible language. More generally, firms must treat customers (including guarantors) fairly, in accordance with Principle 6 of our high-level principles.

- the amount of the overdue payment or payments<sup>8</sup> and the lender's intention to take payment from the guarantor using the CPA or direct debit
  - the likely timing of the payment or payments<sup>9</sup> to be taken, and
  - the guarantor's right to cancel the authority (but making clear that cancellation will not extinguish the guarantor's obligations under the terms of the guarantee)<sup>10</sup>
- 2.14 We would expect the lender to allow a reasonable period before taking payment to enable the guarantor to respond, or to cancel the CPA or direct debit. What is reasonable is likely to depend on the circumstances, but we would generally expect a lender to allow at least five working days following notification.<sup>11</sup>
- 2.15 Where the guarantor is pre-notified in line with the above, and does not object or cancel the payment authority, we would not regard the subsequent use of the CPA or direct debit facility as 'enforcement' of security, requiring a default notice.
- 2.16 In effect, therefore, in our opinion a lender has three options:
- obtain the guarantor's express consent to payment being taken, or
  - pre-notify the guarantor (in writing and with sufficient detail as outlined at paragraph 2.13 above to enable an informed decision) and wait a reasonable period (at least five working days), during which the guarantor can cancel the payment authority, or
  - issue a default notice in accordance with the CCA and wait 14 days
- 2.17 The last of these would remove any legal uncertainty about whether security is being enforced, but it is, in our view, not the only option.

### Other relevant matters

- 2.18 Questions of interpretation of legislation are ultimately for a court to determine and we can only express a view.

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<sup>8</sup> Assuming the borrower makes no partial payment.

<sup>9</sup> If the borrower has missed more than one repayment, a firm may choose to take payments separately from the guarantor (over a period) rather than as a single payment.

<sup>10</sup> As above, all communications must be clear, fair and not misleading.

<sup>11</sup> We would expect such notification to be in writing, but not necessarily on paper (unlike a default notice). This could include using email or SMS/text or other electronic means. In addition, the firm may wish to contact the guarantor by phone (if the individual has indicated that they are happy to receive communications in that way) to check that the notification has been received.

- 2.19 Where a default notice is required under the CCA, failure to serve a valid notice (or to wait the required period before taking action) would be a breach of the CCA. If payment is taken, contrary to section 87, the borrower or guarantor may have a cause of action against the lender.
- 2.20 In such cases, we may consider taking regulatory or disciplinary action against the firm, subject to evidence of actual or potential harm to consumers, the proportionality of opening an investigation and issues of relative prioritisation.
- 2.21 As noted in GC16/7, there is no minimum period before a lender may issue a default notice. In particular, there is no requirement to serve an arrears notice before issuing a default notice, or to wait until two payments have been missed.
- 2.22 For example, the CCA would not prevent a lender issuing a default notice on (for example) day five after the breach by the borrower (with a copy sent or given to the guarantor). Allowing for postal delivery, the notice might expire on day 21, with the lender taking payment from the guarantor on day 22. In this way, the breach could be remedied within the same month. The FCA would not object to this, in principle, provided that the firm can demonstrate compliance with our rules and principles.
- 2.23 We also noted in GC16/7 some potential confusion regarding the provisions for reporting defaults to credit reference agencies (CRAs).
- 2.24 Industry guidelines on reporting to CRAs are set out in the Principles for the Reporting of Arrears, Arrangements and Defaults, which were published in January 2014 by the Standing Committee on Reciprocity (SCOR).<sup>12</sup>
- 2.25 The SCOR guidelines explain that a missed payment may lead to a consumer's account being reported as 'in arrears', whereas a 'default' is limited to a situation where the relationship between the parties has broken down. The guidelines state that, as a general guide, this may occur when the consumer is three months in arrears, and normally by the time he or she is six months in arrears. The guidelines also specify other circumstances when a 'default' may be recorded, such as where there is evidence of fraud, or the account has been included in a bankruptcy or County Court judgment.
- 2.26 As such, it follows that a 'default' on a credit file would not normally be recorded before the account is at least three months in arrears. In contrast, a default notice under the CCA has to be served before the lender can take certain actions, but can be served at any time following breach of the agreement, subject to this following our rules and principles. Issuing a default notice is not, in itself, an event that has to be reported to a CRA (and indeed, it would be contrary to the SCOR principles to do so if the relationship has not broken down – for example, if the lender is merely seeking payment of one or more missed payments rather than calling in the entire debt). Equally, a lender can register a 'default' with a CRA without having previously served a default notice.

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<sup>12</sup> <http://www.scoronline.co.uk/principles>

- 2.27 The SCOR guidelines state that the lender must generally notify the consumer of its intention to register a 'default' at least 28 days before doing so. This is to give the consumer time to make an acceptable payment or to reach an arrangement. However, this is an entirely separate and distinct matter from the CCA default notice provisions. As noted above, any communication with a customer in relation to a credit agreement must be clear, fair and not misleading under CONC 3.3.
- 2.28 In the above example, if payment is taken on day 22, the breach would be remedied for CCA purposes. The account would have been 'in arrears' for that period, and may have been reported as such to a CRA, but the arrears would be rectified before the next monthly instalment is due and no 'default' will have arisen for CRA reporting purposes (as the relationship between the parties has not broken down).
- 2.29 We are aware that this issue has given rise to some misunderstandings, given the different meanings of 'default', and we are taking this opportunity to clarify the position. 'Default' in the context of a default notice under the CCA concerns where, for example, the borrower has failed to pay, whereas 'default' has a different meaning in an accounting context and in relation to CRA reporting.