The Future Regulation of Consumer Credit
- a Consumer Perspective

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This Paper analyses the protection offered to consumers under current consumer credit regulation. It identifies where this protection works well, and where it fall short. It then goes on to assess the potential impact on consumers of a move to a FSMA-style regime and discusses implications of such a move.

The paper is written from a consumer perspective and it concentrates on practical issues. Consequently it does not consider any issue of proportionality in regulation and it also is silent on the potential cost to firms (and therefore consumers) of any regulatory change.

Background to the UK consumer credit sector

It is salutary to note how the consumer choice and use of credit has changed over the last forty years. In the early 1970's there were just two credit cards which came with low credit limits, repayments of at least 5% of the outstanding balance, and no thought of balance transfers, cash-back or similar provisions. Consumers wanting to arrange a loan had to visit their bank branch between 9.30 am and 3.30 pm on a weekday and submit to a personal interview. Homeowners had no thought or prospect of using any house equity to fund anything not directly related to the purchase or improvement of a owner-occupied property; indeed getting a mortgage in the first place required a period of saving with a building society to join the queue for the rationed amount of available funding. Even as late as 1980 the Annual report of the CAB Service made no mention of debt as an individual problem area; debt enquiries being recorded within the general category of 'consumer, trade, and business'. The suggestion to an early 1970's consumer that within twenty years, and particularly if they were homeowners, they would have relative freedom to borrow when they liked to fund spending on whatever they wanted would have seemed outlandish. But that is how the market developed, and hindsight illustrates the downsides as well as the advantages.

The market in consumer credit grew steadily throughout the 1970's. More rapid growth dates from the 1980's with the impact of the 'big bang' in financial services and the entry of the US credit card companies and other financial institutions. Consumers could now choose from a vastly increased range of consumer credit products with more opportunities and flexibility in borrowing. Credit card companies offered increased credit limits and reduced minimum payments. Increased home ownership and rapidly rising house prices had a wealth effect and facilitated equity withdrawal as a means of funding consumer spending. Lending to consumers who had less than a perfect record of repaying previous borrowing became a niche market.

The housing market and wider economic recession of the early 1990's temporarily slowed down consumers' affinity with credit. But renewed house price inflation, greatly increased equity withdrawal, and the growth of sub-prime lending revived an appetite for credit that lasted until the late 2000s financial crisis. Whilst access to mainstream credit has subsequently been restricted, it has been offset by significant

growth in 'payday' and similar lending and increased activity in ancillary areas of consumer credit such as debt management and debt collection.

The growth in consumer credit has clearly been a dual edged sword for consumers. However, the experience allows consideration of how regulation has served consumers over the past forty years and the lessons we can learn.

The Existing Consumer Credit Legislation

The existing raft of consumer credit legislation originates with the 1971 report of the Crowther committee that recommended sweeping changes to consumer credit and led to the enactment of the Consumer Credit Act 1974. The Act was ground breaking in its wide-ranging vision for consumer protection and the regulation and enforcement of its rules. It introduced a licensing system for lenders and for other firms operating as ancillary businesses within the consumer credit sector. It aimed to control many of the ways in which lenders sought and transacted business from how loans could be advertised through to prescribing the rights of consumers entering into, settling, or having difficulties in repaying credit. The Act further set down powers for the courts (and specifically the more consumer-accessible county courts) to control and reschedule loan agreements.

Looking back now at the 1974 Act, this writer notes the farsightedness of the Crowther committee. The Act provides for overarching and ambitious rules to protect consumers in an area of commerce that was ripe for development and innovation. It aimed to protect consumers by looking forward as well as backwards.

An almost inevitable downside of overarching and ambitious rules-based regulation is that of complexity and so it has proved with the 1974 Act. Some elements of the Act came immediately into force but many were left for introduction at the discretion of future governments.

Concern about the rapid growth in consumer credit and the perceived need for changes to the 1974 Act led to calls for amendment of the original legislation. After several years of consultation, Parliament approved the Consumer Credit Act 2006. The new Act introduced a more accessible test for extortionate credit agreements (now called 'unfair lending'), required more information for borrowers, introduced an Ombudsman scheme, increased the level of borrowing covered under regulated agreements to an unlimited amount from the previous £25,000, itself an increase from the original £5,000, and re-defined 'consumer' to include small sole traders and partnerships. Perhaps of most importance, the new Act better empowered and obliged the OFT to strengthen the licensing system, including powers for the Office to impose conditions and to fine non-compliant licence holders.

It is important not to overlook the impact and potential future impact of this major revision to consumer credit law. 2006 is not that long ago and, as with the 1974 Act, the provisions of the regulations were not all immediately introduced. Also, and as discussed more below, the OFT is still testing out and increasingly making use of its new powers. From a consumer perspective, the 2006 Act is a work in progress.

Finally, there has been the impact of European Union legislation on UK regulation. The EU first implemented a Directive on consumer credit in 1987 with amendments in 1990 and 1998. This had little impact on UK consumers because they already benefitted from more protection than required by the EU. However, the continued growth in consumer credit and the desire by Brussels to both protect consumers and encourage cross border trade in consumer credit led to the European Council adopting the May 2008 Consumer Credit Directive (CCD). Legislation implementing its provisions subsequently came fully into force in the UK on 1 February 2011. The CCD was a maximisation harmonisation measure – i.e. national governments had no discretion to opt out.

Changes introduced by the CCD are intended to better protect consumers. Post February 2011, credit advertisements must provide more information to help consumers compare credit agreements; lenders are required to comply with a 'responsible lending' requirement to obtain sufficient information to assess a borrower's ability to repay any loan; and lenders must also offer an 'adequate explanation' of a proposed credit agreement. In addition, the CCD introduced a 14 day cooling off period for a borrower to withdraw from a credit agreement, and it further allows a borrower to make partial early settlement of their consumer debt.

Preparations for introducing the CCD required substantial investment from both UK firms and the OFT. The OFT estimated the costs of implementing the CCD as between £49.2m and £176.2m with further average annual costs of £132m to £145.7m[1].

How the Existing Regulation Works Well for Consumers

The regulation provides a powerful raft of protection

Current UK consumer credit regulation offers a comprehensive raft of measures designed to inform and protect consumers[2] with the certainty of a rules-based approach. Lenders and other firms associated with consumer credit are licensed, with the OFT being able to quickly respond to detrimental business practices by imposing control orders. The advertising of credit is strictly controlled with pre-contract disclosure obligations and borrowers having unfettered 14-day discretion to withdraw from a credit agreement. Credit providers must give adequate explanations to ensure that borrowers make an informed choice on whether they should take out the credit, with lenders also being obliged to confirm that borrowers can afford to repay proposed borrowing, and borrowers having the right to make early settlement of their debt either in full or in part. The original unhelpful/unworkable extortionate credit provisions of the 1974 Act have been replaced by a wider 'unfair relationship' test, and dissatisfied consumers have access to the free of charge dispute resolution mechanism offered by the FOS.

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[1] http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/10-916-implementation-impact-assessment-consumer-credit-directive

[2] Appendix A of the HMT/BIS Consolation paper provides a useful list of the core consumer protections enshrined under the CCA. *A New Approach to Financial Regulation – consultation on reforming the consumer credit regime*. HMT/BIS December 2010

This is powerful protection for consumers. Moreover, some of the safeguards are remarkably strong. The well known Section 75 and 75A of the Act provides that consumers using credit to buy goods or services, even overseas[3], have an equal claim against the seller if the item is faulty or the seller misrepresents the item. This protection is now firmly embedded as a consumer protection measure and so will hopefully not come under attack in any transfer to a FSMA regime. But assume for a moment that the CCA did not exist or is revised. The Panel might share this writer's expectation of the withering response of the banks and credit companies to a suggestion that they should have joint and several liability to fully compensate a UK tourist who uses a credit card to buy an 'antique 'carpet in a Turkish market where the expensive heirloom is a recently produced sham.

Similarly, sections 129 and 136 are powerful allies for consumers in financial difficulty. Section 129 allows the court to make a 'time order' where a borrower cannot afford to repay the amounts owing under a regulated agreement. If the court considers it just to make such an order then the repayment schedule must only be based on the borrower's ability to pay. Section 136 then gives the court the power to reduce the rate of interest chargeable as a result of making a time order.

The OFT has been significantly more proactive in recent years to intervene in the consumer credit market

Historically, most consumer advocates expressed disappointment with the cautious approach of the OFT to the consumer credit market and its lack of appetite to actively intervene. The licensing system was particularly criticised as an essentially administrative procedure where the main obstacle to being granted a licence was the payment of the required fee. However, the additional powers for the OFT in the 2006 CCA has led to a noticeable and welcome step-change as set down in 'The OFT's regulatory approach in its Consumer Credit responsibilities'[4]. Recently, one challenge for consumer advocates has been in keeping abreast of the OFT's work and how its developing work can be used to best support consumers.

Of particular note is the way the OFT has produced guidance to set down its expectations in various areas of consumer credit. In 2011, OFT guidance or consultation on guidance includes debt collection[5], debt management[6], group consumer credit licensing[7], unfair relationships[8], payment protection products (joint with FSA)[9], lending to consumer with mental capacity issues[10], and credit brokerage[11] .

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3 See the landmark judgment of Office of Fair Trading (Respondents) v. Lloyds TSB Bank plc at http://www.publications.parliament.uk/pa/ld200607/ldjudgmt/jd071031/lloyds-1.htm The Banks objected strongly to the OFT assertion that s75 provided overseas protection to UK credit-card holders and took the matter all the way to the House of Lords

4 http://www.oft.gov.uk/shared_oft/business_leaflets/credit_licences/OFT1262.pdf
5 http://www.oft.gov.uk/shared_oft/consultations/oft664con.pdf
6 http://www.oft.gov.uk/shared_oft/consultations/OFT1338con.pdf
7 http://www.oft.gov.uk/shared_oft/business_leaflets/credit_licences/OFT990rev.pdf
8 http://www.oft.gov.uk/shared_oft/business_leaflets/enterprise_act/oft854Rev.pdf
9 http://www.oft.gov.uk/shared_oft/consultations/ppp.pdf
10 http://www.oft.gov.uk/shared_oft/consultations/oft1373.pdf
11 http://www.oft.gov.uk/shared_oft/business_leaflets/consumer_credit/oft1388.pdf

Whilst the guidance has had to go through the usual horse trading of consultation and it comes with the warning that it has no legal force, the plain English clarity and the willingness of the OFT to take a stance has been welcome. It enables consumers and their advocates to understand the regulator's thinking and its expectation of how firms (and consumers) should act. It is also notable that firms and trade associations – or at least those that subscribe to the principle of Treating Customer Fairly – generally welcome the guidance as providing clarity and thereby enabling firms to plan and implement any necessary changes to their procedures.

The step-change in the OFT approach is also evidenced through increased enforcement action against consumer credit firms. Now that it is no longer limited to the nuclear option of withdrawing licenses as a means of controlling consumer-detrimental activities, the OFT can better work to identify and remedy the failings of license holders. The OFT website[12] provides information about recent decisions to impose requirements on licence holders, to issue a 'minded to refuse/revoke notice, in addition to decisions to actually refuse or revoke a licence.

The OFT Consumer Credit Group Newsletters[13], themselves another positive development in communication to stakeholders, offer a useful quick overview of recent OFT work in the consumer credit sector,

It is not only the OFT that has been encouraging and requiring changes in the consumer credit sector. The 2010 BIS review of credit and store cards has led to the industry agreeing to consumer-beneficial changes such as first allocating repayments against highest interest rate debt and providing an annual statement to allow for easy cost comparison with other forms of credit.

The Financial Ombudsman Service (FOS) is gaining experience in deciding on consumer credit issues and communicating to consumers and firms.

In April 2007 the FOS gained jurisdiction to determine complaints from consumers about consumer credit disputes. This built on its existing remit from inception of the Service to decide complaints about the consumer credit activities of banks and building societies authorised by the FSA.

Whilst the FOS does not replace the courts in interpreting the CCA (and consumers still have the right to apply to the courts if dissatisfied with a FOS decision), the option to apply to the FOS provides a straightforward, cost-free option for consumers.

In its annual review of 2010/11[14] the FOS reported that it had that year dealt with 7,250 complaints about consumer credit products and activities, plus additional complaints about credit cards (17,466), and unsecured loans (5,820), all of which are very likely to refer to matters regulated by the CCA. This is a relatively low number given the size of the UK consumer credit market. However, as a complaint category, it increased by 15% over the previous year and it is also relevant to note that

[12] http://www.oft.gov.uk/OFTwork/credit/enforcement-action/
[13] http://www.oft.gov.uk/OFTwork/credit/ccg-newsletters/
[14] http://www.financial-ombudsman.org.uk/publications/ar11/who.html

additional complaints were fielded by the self-regulatory Lending Codes. Assuming that the profile of the FOS continues to increase such that all consumers understand its remit as an independent and impartial decider of consumer credit disputes, it seems reasonable to assume that the FOS will field more complaints in the future.

The FOS has also reported[15] various case studies which, although currently limited in number, helpfully set down how it has decided various consumer credit cases. Again, these plain English decisions are very useful to consumers and consumer advocates in considering consumer rights and responsibilities.

Looking forward, the FOS has recently consulted[16]on its wish to publish all Ombudsman decisions and the Panel supports the FOS proposals[17]. It seems reasonable to suggest that publication of FOS decisions on consumer credit will make it easier for consumers to understand the practical interpretation of the CCA provisions.

How the Existing Regulation Fails to Adequately Protect Consumers

It can be seen that consumers currently benefit from a well-considered and developed range of consumer credit regulation. Therefore the first question that any consumer might ask is, 'why change anything?'

Inevitably, a consumer-focussed analysis will identify gaps and problems in how the existing regulatory approach protects consumers.

The regulation is complex with consequent problems for consumers

The Consumer Credit Act is a complex and lengthy piece of legislation, which is often difficult to interpret[18]. This makes for a practical problem for consumers and their advisers. There is then the added difficulty that there are gaps in the range of authoritative judgments on consumer credit issues to set down how the courts interpret the law.

The absence of such judgments, the complexity of the law, and the challenge of applying historic law to subsequent industry developments means that consumers face obstacles in applying to a court to assert what they think are their legal rights.

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15 http://www.financial-ombudsman.org.uk/publications/ombudsman-news/86/86-consumer-credit.htm http://www.financial-ombudsman.org.uk/publications/ombudsman-news/81/81-debt-collecting.htm
http://www.financial-ombudsman.org.uk/publications/ombudsman-news/75/75-consumer-credit.html
http://www.financial-ombudsman.org.uk/publications/ombudsman-news/75/75-consumer-credit.html

16 http://www.financial-ombudsman.org.uk/publications/policy-statements/publishing-decisions-sep11.pdf

17 http://www.fs-cp.org.uk/publications/pdf/response-fos-consultation-ombudsman-decisions.pdf

18 Even experienced Judges have been moved to note the consequent problems. In Jenkins v Lombard North Central plc [1984] Lord Justice Goff described the CCA as '...an Act of extraordinary length and complexity which must raise very considerable problems for those...citizens, whether corporate or individual, who are affected by its terms'. In Davies v Direct loans Ltd [1995] a High Court Judge concluded his judgement by saying, 'I should like to express my indebtedness to counsel for their assistance not only to the somewhat convoluted provisions of the 1974 Act and of the regulations made under it, but also for the clarity with which they explained some of the mathematical calculations involved in the ascertainment of true rates of interest which are of such vital importance under the Act.

Their first hurdle is in seeking out appropriate legal advice. In such a specialist field with limited case-law it is invariably the cases that the expert lawyers regularly advise and act for lenders. These lawyers are therefore rarely available to advise consumers. Very few high street practices willing to act for borrowers can match the specialists for experience and technical know-how. CAB and similar money and housing advisers do their best and are often very knowledgeable about the law, but it is a brave lay adviser that suggests their legally unrepresented client takes on a bank or finance company. No doubt the advice agency's professional indemnity insurers would replace 'brave' with 'reckless'...

Even if specialist legal advice is available, the consumer will have to face the issue of costs. Here the challenge is not just in paying for their own costs and legal advice. If legal action results in a successful defence by the creditor, the consumer will almost certainly be ordered to pay additional costs. Given that the creditor is likely to have instructed specialist legal opinion to advise and represent on the complexities of the Act these costs will probably be considerable.

The challenge in using the courts to protect consumers is demonstrated by the time order procedure. As indicated above, a time order is a powerful ally to a consumer in financial difficulty. Given the level of consumer debt, the number of consumers in financial difficulty, and complaints from consumer organisations that lenders/debt collectors often fail to respond positively and sympathetically to borrowers in financial distress, one would reasonably expect a significant use of the time order procedure. Unfortunately there does not seem to be any official record of the number of time orders made by the courts but what evidence exists suggests that they are few.

A time order is most useful and important when a borrower has arrears on a CCA regulated secured loan and is facing a claim for repossession of their home. Unlike a first mortgage, where the law allows the court only to reschedule the arrears over a 'reasonable' period but still requires repayment of the ongoing contractual instalments, the time order provisions allow the courts to replace both arrears and future payments with new instalments based on the borrower's ability to pay. Yet a joint report from Shelter, Citizens Advice, and Advice UK on July 2009 evidence from money and housing advisers working at County Courts showed just one application for a time order and no order actually made[19].

The reason for such few applications is conjecture but the experience of this writer is that borrowers do not know or are uncertain about the time order procedure and non-legally qualified money and housing advisers are nervous of suggesting applications because of the problems already discussed above. So the CCA protection for consumers works well in theory but not in practice.

Of course, the problem that consumer borrowers find it difficult to litigate on a level playing field was addressed with the 2006 revision to the CCA and the subsequent availability of the Financial Ombudsman Service as an alternative dispute resolution mechanism. If the FOS succeeds in increasing its visibility and accessibility to

[19] Turning the Tide, December 2009
http://england.shelter.org.uk/__data/assets/pdf_file/0020/236342/Turning_the_tide_FINAL.pdf

consumers and offers a quick and effective method of resolving disputes, then many of the obstacles of court applications become less important.

There is one further issue regarding the complexity of the current legislation. It concerns the activities of claims management companies who identify technical breaches in the CCA or seek to use the complexity and uncertainty of the Act to persuade consumers that they have arguable rights of redress. Identifying the activities of these companies as a failure of the existing legislation would be challenged by those who argue that these companies simply assert consumer rights in ways missed by CAB and similar advisers. Moreover, many consumers will no doubt feel that the banks and finance companies do not deserve much sympathy if they are losing out to the claims management sector. Yet, the scatter-gun approach of claims management companies primarily looking to boost their own profits is, at least in the opinion of this writer, at odds with the longer-term consumer interest. As Judge Simon Browne said in a recent case involving financial advisers seeking to claim that they should not have to repay their debts because of technical breaches of the CCA, "*the Consumer Credit Act was introduced to protect the individual unsophisticated in financial affairs in contracts with unscrupulous and sophisticated financial institutions. It was not designed to help individuals in the financial services business make money out of financial institutions through exploiting its undoubted technicalities*"[20].

The tortuous approach to implementing consumer credit regulation – Statutory Instruments

Reference has already been made to the staged introduction of the 1974 CCA. Remarkably, many of its provisions were not implemented until May 1985. By that time the original drafter of the Act, Francis Bennion, was so frustrated that he had written to the Times to complain about the 'political dithering by a succession of Ministers' that 'passed beyond maladministration into the grounds of illegality'[21]. Inevitably, and in the first hand experience of this writer, by the time of the 1985 implementation the potential beneficial impact for consumers was limited by the passing of time, the lack of awareness and expertise amongst consumer advocates of the intentions and concerns of the Crowther committee, and the already discussed practical problem of consumers being able to enforce their (arguable) rights.

The delay in implementing the 1974 provisions confirms the inflexibility of making regulation through primary legislation implemented through affirmative Statutory Instruments which require consultation and parliamentary time. Measures that had long been identified as appropriate for consumer protection had to wait for future governments to support and action.

The cautious approach to implementing consumer credit regulation – the CCD

A similar delay is seen in the progress and implementation of the Consumer Credit Directive. However, this also demonstrates the challenge to policy makers in having to negotiate a change to policy on a national and European basis and draws out the

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[20] Rankine –v- American Express Europe Ltd & others, High Court QBD, May 2008
[21] Francis Bennion, letter to Time Newspaper, 3rd February 1983

challenge of the relative lobbying power of industry and consumer groups in any stakeholder consultation.

The CCD had a long and difficult gestation period with the European Commission first introducing proposals in 2002. Various iterations then followed with one consistent response being the resistance of the UK consumer credit and mortgage industry to the European proposals. However, it was not only the industry that had concerns. Consumer groups were also worried that the maximum harmonisation proposals might take away some existing UK protection[22].

The proposals in the CCD were gradually changed from 2002 through 2008. Nevertheless, industry advisers were still anxious about how the government would implement the CCD, particular in the area of 'adequate explanations'. The following August 2009 extract of an article aimed at consumer credit firms gives a flavour of the challenge;

This [adequate explanations] is probably the single biggest headache under the Directive...The simple basic rule is that before the agreement "is made" the creditor has to provide the debtor with adequate explanations of a list of matters set out in the draft Regulations together with an opportunity for the debtor to ask questions. If the adequate explanations and the answering of questions has been done by a "credit intermediary" (a very widely defined term) the creditor doesn't need to do it too. The industry must have a concern with the more complex products that explanations will be challenging to give. There is very little appreciation in BIS of the complexity of some products regulated by the CCA and by the Directive, as most of their understanding is of simple vanilla lending and hire purchase. Clearly, there will now be a cost to creditors in preparing standard explanations to be given for each product. What is not yet clear is how creditors are going to deal with the opportunity which has to be made available for questions to be asked. We should also bear in mind that in face-to-face and telephone transactions the opportunity is supposed to be dealt with orally. Much anguish has been expressed in lobbying about what happens in a busy store on a Saturday afternoon with a harassed shop assistant whose expertise on credit products is limited. Is the answer to set up a helpline? Does that helpline need to be manned 24 hours a day? This may not be practicable for smaller finance companies (a group which tends to be ignored by BIS). What about the motor dealer?

There is little doubt, going forward, that creditors will want to have controls in place about what their intermediaries say. We should also brace ourselves for future litigation and ombudsman complaints as customers try to aver what misleading answers were given to their questions.[23]

In April 2009, the former Department for Business, Enterprise and Regulatory Reform (BERR) published a consultation document seeking views on its proposal for

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[22] Panel members particularly interested in knowing more about the CCD debate will find the July 2006 report of the House of Lords European Commission to be of interest. The report also highlights how the debate about how far a regulator should intervene
http://www.publications.parliament.uk/pa/ld200506/ldselect/ldeucom/210/210i.pdf

[23] http://www.morton-fraser.com/publications/articles/256_draft_regulations_implementing_the_consumer_credit_directive_update_4

implementing the CCD. BERR received 67 written responses; 4 of which were from consumer bodies.

Predictably, the responses on how the UK should implement ‘adequate explanations’ were polarised, with industry wanting simple and minimum level information whilst consumer groups pressed for more detail. The eventual Government response was perhaps also predictable in splitting the difference by ‘rationalising’ the extent to which adequate explanations should be provided but refusing the industry proposal that consumers be allowed to opt out.

When the CCD was introduced into UK law in February 2011 the Consumer Affairs Minister, Edward Davey, had fulsome praise for the new requirements, “The implementation of the Consumer Credit Directive will help strengthen a culture of responsible lending. With new legal rights for consumers and greater responsibility for lenders, consumers will be better able to take charge of their money”.

So, with all this background, the writer poses a question for Panel members. How much difference have they noticed or had reported to them in the explanations given to consumers applying for credit since February 2011? If, like the writer, they have seen little change, does this not bear out the (unsurprising) tendency of the industry to resist change unless there is a regulatory culture and leadership that ensures a real difference for consumers?

Inadequate resources to monitor and enforce the CCA and react to changes in the consumer credit sector

The effective regulation of the UK consumer credit market is clearly important to consumers. The HMT/BIS consultation paper reports[24] that around two-thirds of all households borrow money, up from just under half in 2002. In the first nine months of 2010, almost £131 billion was lent to UK consumers. The number of people using payday loans has quadrupled in the last four years to 1.2 million and the number of pawnbroking outlets is estimated to have increased from 800 in 2003 to 1,300 in 2010. There are around 96,000 holders of consumer credit licences.

As the licensing authority and the main enforcement body, the OFT is the lead regulator although local authority Trading Standards officers share the enforcement responsibility.

Resources to monitor and enforce consumer credit legislation will always obviously be limited but it is apposite to note the relative small number of staff allocated to the consumer credit group at the OFT. The group administers all aspects of the credit licensing regime, casework and other initiatives to achieve compliance with the Act and to ensure consumers are not harmed. It also covers credit policy issues.

The limited resource means that the OFT has had to prioritise its work in monitoring and enforcing the CCA and in responding to industry developments. It has done this by identifying ‘high risk’ activities, which currently include debt counselling and debt

[24] Paragraph 1.8 et seq, *A New Approach to Financial Regulation*. HMT December 2010

management, debt collection, and providing consumers with information and credit services (including credit repair).

As discussed above, the OFT have undertaken a wide range of work within this priority work stream with, at least in this writer's opinion and experience, significant impact and consequent benefits for consumers. However, the priority work streams clearly cover only a part of consumer credit activity.

The limit in resources is no doubt one reason the OFT consider that self-regulation by firms and trade bodies is important in monitoring and compliance of consumer credit regulation. The Office has given a public commitment to working with self-regulatory bodies where it considers that these bodies add value to consumer protection[25].

Effective self-regulation offers consumers relatively inexpensive and speedy resolution of problems that they might encounter in their dealings with firms. However, the Panel will be well aware of the challenges of self-regulation and the particular importance that the governance structure of self-regulatory organisations allows proper consideration and effect of the consumer interest.

Self-regulation also often seems strange to consumers. For example, just last month, the OFT agreed a Memorandum of Understanding with the Lending Standards Board on responsibility for consumer credit issues[26]. Given recent experience and the current level of consumer dissatisfaction with the major banks, a passing consumer might question whether leaving the monitoring and compliance of banks and other large lenders to a voluntary code introduced and still highly influenced by a trade body is an effective means of ensuring compliance with regulation.

Similarly Local Authority Trading Standards have limited resources. These resources are also being reviewed in the light of local authority cutbacks. UNISON claimed in March 2011 that some Trading Standards departments faced job cuts of up to 50%.

When considering the options to monitor and enforce future consumer credit regulation, it is notable that the Crowther Committee proposed a new department of investigation headed by a consumer credit commissioner. The original draft of the 1974 Act supported this proposal. However, it was subsequently removed by the incoming Labour government in 1974 with the task of monitoring and enforcing the act falling instead to the Director General of Fair trading.

It is interesting to ruminate on whether consumers would have been in a better position to respond to the challenges of the last forty years if Parliament had followed the Crowther Committee's original recommendation. The Committee considered the appointment of a Commissioner as of major importance to their overall proposals. Not only would the Commissioner have responsibility for licensing and enforcement but they would also act as an ombudsman, educate consumers, and stay abreast of

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[25] The role of self-regulation in the OFT's consumer protection work http://www.oft.gov.uk/shared_oft/reports/consumer-policy/oft1115.pdf

[26] http://www.oft.gov.uk/shared_oft/MoUs/MoU_between_the_OFT_and_the1.pdf

industry developments to ensure that the reformed law never became as inadequate as the pre 1974 legislation.

Inadequate information/education on consumer credit issues

An effective consumer protection regime for consumer credit would surely provide ready access to high quality, independent, and free information to enable consumers to understand their rights and responsibilities. This is particularly important given the already discussed relative complexity of the legislation. However, whilst there is plenty of available information, more could usefully be done to bring it into one place as a consumer resource.

The internet is an increasingly important first port of call for many consumers seeking information about their rights and options, and typing 'consumer credit act rights' into Google produces nearly 37,000,000 results. The top result identifies the Which? Site; a link that provides good information aimed at consumers. Further down the first page there is also a link to the Citizens Advice 'Advice Guide' website, which also provides independent information for consumers. However, other links on the first page of results are unhelpful to the uninformed consumer as they refer to web pages which contain out of date information or link to sites that require payment for advice and information.

Surprisingly, the Google search produces no link to the Money Advice Service (MAS). More generally the website of the MAS seems weak in how it provides information on consumer credit issues. For example, typing 'time order' or 'unfair relationships' into the MAS search engine produces no results at all. Typing in 'consumer credit act' produces many results, but nothing that leads to overarching information or advice about the legislation. To be fair, the top result leads to a page that further refers on to the consumer credit section of the OFT website. However, the OFT site[27] is (understandably) not solely aimed at consumers and written accordingly. The OFT site also comes with the clear caveat that, 'Please note the OFT is unable to provide tailored advice to individuals. To find out your rights under the [consumer credit] Act or other legislation you should obtain independent advice'. The Panel might sympathise with the consumer who thought that was what they were initially expecting on the Money Advice Service website.

Again, it is interesting to note the Crowther Committee's original identification of the need for a dedicated education resource for consumers. The Panel may wish to consider whether such a dedicated information/education resource for consumers remains appropriate and whether the MAS is willing and able to take on this role in the new regulatory approach.

The Implications for Consumers of Transferring Consumer Credit to a FSMA-Style Regime

The HMT/BIS consultation paper sets out the Government's belief that 'bringing responsibility for consumer credit within a legal framework based on the model set out in the Financial Services and Markets Act could deliver stronger protections for

[27] http://www.oft.gov.uk/about-the-oft/legal-powers/legal/cca/

consumers, remove unnecessary regulatory duplication and burdens for business, and help to address anomalies that currently mean that similar products can be regulated under different regimes'[28].

The HMT/BIS paper argues that a FSMA style regime would have many advantages. For example, it would ensure clearer accountability and coherence by bringing regulation of all retail financial services under one regime, and be more flexible in responding to concerns, providing an opportunity to enhance consumer protection and for quicker action to remove provisions that are out of date or duplicative. However, it is notable that the consultation does not specifically refer to how the current consumer credit legislation fails consumers.

Potentially Positive Implications for Consumers of Transferring Consumer Credit to a FSMA-Style Regime

FSMA-style regulation enables a more effective response to market innovation and developments

The nature and extent of the consumer credit sector means that firms will continue to innovate over all stages of the economic cycle. Even when conditions are challenging - as now - there is innovation in debt collection, credit reference agency procedures, debt management, and lending to borrowers who are no longer served by high street banks or who may choose to test out new borrowing products. Recent reports of US innovation that could transfer to the UK and require regulatory attention includes the use of social network information in credit scoring and the growth of lending through prepaid credit cards.

The CCA rules-based approach backed by OFT guidance in high-risk areas could be found wanting in responding to market innovation. It is an understatement to say that the rules cannot be changed quickly, and the innovation may fall outside the boundaries of those activities identified as high–risk. Any response to protect consumers may therefore fall to self-regulation.

The FSMA approach, on the other hand, would allow more flexibility for the regulator to respond to market innovation, particularly if the FCA objectives include new powers in product innovation.

Good regulation administered by poorly resourced regulators does not make for effective regulation. A FSMA approach offers a new start to funding of the regulation of consumer credit

The government's commitment to reducing public spending means that the OFT is unlikely for some years to receive more resources to increase its consumer credit work. Local Trading Standards departments are facing heavy reductions in budgets and staff numbers.

It is essential that regulators are given adequate resources. Moving to a FSMA approach offers a new start with, perhaps, consideration of higher license fees for firms in different segments of the market.

[28] Forward to '*A New Approach to Financial Regulation*'. HMT/BIS December 2010

A new dynamic regulator with no historic baggage can re-shape the relationship between consumers, lenders, and others in the consumer credit market

From a consumer perspective, there is a commendable level of future ambition for the FCA. The FCA 'will be prepared to step in early to prevent consumer detriment... The fair treatment of customers will be a central part of the FCA's role in regulating the industry... The FCA will be forward-looking and preventative; it will move to a more forward-looking assessment of potential detriment to identify problems that need to be tackled... The FCA will also put a premium on analysis and good judgement...The FCA will adopt a proactive 'can do' approach... The fair treatment of customers will be a central part of the FCA's role in regulating the industry'[29].

These are stirring words and they build on the changed approach from the FSA over recent years.

Effective regulatory control of consumer credit to protect consumers requires oversight of the supply of finance to lenders

A major cause of the financial crisis was the growth of new sources of funding outside the established banking sector. Effective regulation of consumer credit requires control of securitisation and other supply issues. A FSMA approach administered by the FCA plugged into oversight of the whole financial system is best placed to provide this.

Potential for better supervision of consumer credit firms

The current system of regulation does not provide for supervision of consumer credit regulated firms unless they are supervised in other matters by the FSA. Transferring firms to the FCA would offer more assurance to consumers that consumer credit firms were subject to the attention of the regulators.

Brings regulation of all retail financial services under one regime

THE HMT/BIS consultation paper highlights the benefit of a single regulator for all consumer financial products and there are undoubted regulatory challenges where consumer credit products are linked to consumer detrimental developments not covered by the CCA. For example, financial products sold in association with credit cards. However, it is not clear to this writer that this consumer detriment is a particularly strong justification to a change to a one-regulator FSMA-style regime. From a consumer perspective, the role of the FOS is likely to be more crucial so long as the FOS can always accept consumer complaints about all aspects of the relationship between consumers and the financial services sector.

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[29] Margaret Cole speech, June 2011
http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0628_mc.shtml

Potentially Negative Implications for consumers of transferring consumer credit to a FSMA-Style Regime

A principles based approach to consumer protection has been tried and found lacking

A typical consumer has learned more in recent years than s/he probably ever wanted to know about how FSMA-style financial regulation failed to prevent a financial crisis. They might be initially surprised at the suggestion that the same approach should now be used to regulate credit cards, banks loans, hire purchase, debt collectors, and debt management companies.

Consumer credit is a poor fit with the other work of the FCA

The Consumer Panel is better placed than any other consumer group to understand the scale of the future challenge for the FCA. But as confirmation, Margaret Cole's speech in June 2011 laid down the gauntlet;

'The scale of the challenge is large. The FCA will regulate the provision of financial services to an immense range of consumers – from retail consumers taking out a mortgage or buying a pension – through to major organisations raising capital in the international markets...It will have a sharp focus on conduct matters but it will also be a prudential regulator of more than 24,000 firms. Although the FCA will not have explicit responsibility for financial stability it will play a role in the FPC which will be responsible for the oversight of the financial system as a whole. And it will also work alongside the Prudential Regulation Authority (PRA) which will supervise deposit takers, insurers and a small number of significant investment firms... The main challenge ahead is for the FCA to devise new approaches which prevent consumer detriment in the first place, not just focusing on ensuring redress after the fact. It will mean pushing the boundaries of its competition mandate'

This is a substantial in-tray for a new organisation. How well will the FCA be placed or enthused to take on the additional – and major - responsibility of consumer credit?

Consumer credit regulation has often to consider the protection of vulnerable consumers that want/need to borrow relatively small amounts (although such sums may be considerable in terms of individual consumer income). When compared to other pressing issues requiring the attention of the FCA, these low value agreements may struggle for consideration, particularly as the FCA will no doubt be regularly reminded of the 'essential philosophy' of its operational model that regulatory interventions should be proportionate to the risk they seek to address' [30]

Also, given the wide remit of the FCA, a period in consumer credit regulation may not attract FCA staff looking for the higher profile and, being blunt, higher-salary career potential of regulation of investment or wholesale issues. Working in consumer credit regulation will be a very different challenge from other areas of FCA work and the Board and Executive will need to ensure that consumer credit does not become the poor relation.

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[30] Paragraph 2.18, *A New Approach to Financial Regulation*'. HMT/BIS December 2010

FCA regulation of consumer credit suffers from Canary Wharf capture

The Panel will be aware of the often rarefied atmosphere of working at Canary Wharf. The future FCA will presumably continue to work from the FSA offices at the hub of one of the world's leading financial centres. The reception waiting area will no doubt continue to be generally populated by national and international lobbyists wanting to persuade FCA staff of the importance of their vested interests. The immediate surrounding environment will continue to be one of relative affluence.

This is not meant as a criticism of FSA/FCA staff or as a criticism of others who work for the financial services sector in Canary Wharf. They all play their part in sustaining a vital part of the UK economy to the benefit of all UK consumers. Indeed, they are also all consumers themselves. But it is appropriate to suggest a sense check that what the FSA and the future FCA staff see in the course of their working day contacts is much removed from the life of consumers living far away from London. And it is the life events and experiences of consumers that the FCA will have to consider if they are to appropriately change and oversee consumer credit regulation. Similarly, oversight of consumer credit licence holders requires understanding and constructive interaction with businesses who are not based in London and who have a very different ethos to the major financial firms – for example, sole trader home credit providers and debt management firms. At the very least, the FCA will have to find a way of replicating the local intelligence and experience provided by Trading Standards within the current regulatory system, for example in the case of persistent related complaints about local providers of goods and services that are financed by credit, such as second-hand cars and building work.

The challenge here does of course go further than consumer credit. The effectiveness of a future FCA requires that it understands and reflects the consumer reality and does what the Panel has already set down as a requirement of the FCA - to put the consumer at the heart of what it does.

The CCD requirements stay whether we like it or not

The CCD is a maximum harmonisation measure. Its provisions are not, at least as this writer understands them, an optional addition to UK legislation and so they will remain irrespective of any change to the UK regulatory approach. The introduction of the CCD was intrusive, expensive, and occurred within the past twelve months. Given the price that consumers are currently paying for the acknowledged failure of previous financial services regulation, it seems strange that the government would want to add to the cost of regulation unless it is clearly in the consumer interest.

How will the FCA monitor and enforce 96,000 CCA licences?

The most recent-stated ambition is that 'the FCA aims to have some form of regulatory contact with all of the firms it supervises over a four year period. Whether this contact – or 'touch-point' will take the form of a compliance visit will depend to a large extent on the FCA's resources'[31].

[31] Margaret Cole speech, June 2011
http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0628_mc.shtml

If the FCA does take on consumer credit then obviously the regulatory contact with most of the new regulated firms cannot be through a compliance visit. Even if thought appropriate, visits to 96,000 consumer credit firms over a four-year period would be physically impossible – it works out at an average of 461 visits for every week of the four-year cycle. So some form of tick box or desktop compliance seems likely. If so, how does this offer greater consumer protection than the current OFT licensing system supported by the local Trading Standards?

One answer to this question, as suggested by Paragraphs 3.29 through 3.33 of the December 2010 HMT/BIS consultation, is that the FCA introduces an Appointed Representatives (AR) approach for the current large numbers of small licensees. These small companies and sole traders would contract with an FCA authorised firm which would accept responsibility for the regulated activity of the smaller organisation.

It is clear that there are obvious challenges with an AR regime for consumer credit. For example, credit brokers work with a range of lenders and many credit sales are made through retail intermediaries. Also, the background and basis of credit products provided by small firms means their businesses are very different from the larger firms. The HMT/BIS consultation paper was notably light in identifying and analysing these issues and the Panel may wish to press for more detail.

From a consumer perspective, the Panel will also no doubt consider the evidence of the AR regime following the FSA regulation of mortgages and general insurance. Both markets saw consolidation with a reduction in the number of small firms. Was this a positive outcome for consumers given that the same consolidation seems a likely outcome for a consumer credit AR regime?

Another answer could be that the FCA would take regulatory responsibility for only a part of the consumer credit market. For example, responsibility for debt management companies could be passed to the Insolvency Service, which has experience in regulating Insolvency Practitioners. Again this would need more much analysis; simply dividing up the consumer credit regulation so that it fits the resource capacity of the FCA does not immediately seem in the consumer interest.

Rules create more certainty

This is the flip side of a principles based approach. Whilst consumer credit rules are often difficult to understand, they are at least substantive and can be explained through the addition of guidance from the regulator and information aimed at consumers. Principles, as the Panel well knows, can be more problematic. In theory they allow a confident regulator to act quickly to address consumer detriment. In practice the assessment of what it means for a firm to abide by a principle, for example ‘to treat customers fairly’, has proved contentious and difficult to implement and enforce.