creditaction
Better thinking about money

Financial Services Authority

FSA CP13/7: High-level proposals for an FCA regime for consumer credit

A Response by Credit Action

Background

Credit Action is a national financial capability charity (registered Charity in England & Wales No. 1106941) established in 1994.

Credit Action empowers people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives. It develops and delivers products and services which provide education, information and advice on money matters, in an appropriate way for young people and adults. Through its work Credit Action reaches over 500,000 UK citizens every year.

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Introduction

As an organisation, Credit Action is committed to helping people build their financial capability, and develop the skills necessary to manage their money effectively. In our view, fair and well-functioning markets are crucial to enabling consumers to make the best use of these skills, and to ensuring that they are able to make financial decisions in an informed and objective manner. We therefore maintain a keen interest in regulatory developments, particularly with respect to the conduct regime.

The transfer of consumer credit regulation from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA) is a hugely significant change to the regulatory landscape, and will have an enormous impact for consumers and firms alike. However, it is a shift that we very much welcome, and we would like to make clear at the outset of this response that we believe the introduction of a stronger, rules-based regime has the potential to provide greater protection for consumers than has been possible under the OFT's licensing system, and therefore drive real benefits in the consumer credit market.

There are, though, certain areas in which we feel there is a need for much greater clarity around the FCA's approach. One particularly significant issue is the way in which not-for-profit "debt advice" will be defined. At present, we are concerned that a very broad range of activities, including even the provision of generic budgeting advice, could fall within the FCA's definition as it currently stands and therefore be subject to regulation. This would have considerable implications for a large number of organisations and services. We discuss this in detail in our answer to Question 17.

In responding to this consultation, we have focused in particular on addressing Questions 1, 2, 4, 7, 11, 16, 17, 19, 20, 22, 23, 24 and 27, and set out both where we feel the proposals for reform of the consumer credit regime are particularly strong, as well as those issues that we believe still need to be addressed.

Question 1: Do you agree that our proposals strike the right balance between proportionality and strengthening consumer protection?

In general, we believe that the FCA's proposed approach is pitched correctly, and believe that a genuine attempt has been made to strike the right balance between proportionality and consumer protection. Although detailed rules for the new regime will not be released until later this year, and there are also certain issues that we believe need to be addressed at this stage (as we will discuss in full later on), overall we do view the FCA's high-level plans for the new consumer credit regime positively, and feel they will be capable of driving benefits for consumers moving forward.

We would point out, however, that once the new regime is in place, it will be important for the FCA's to take due account of consumer dynamics when making decisions, interventions and rules, in order to ensure that such regulatory measures do not have unintended consequences for consumers or inadvertently end up causing detriment.

Question 2: Do you agree that we have included the right activities in the higher and lower risk regimes?

With respect to higher and lower risk activities, we welcome the fact that commercial providers of debt adjusting and debt counselling services are classified as higher risk. We believe that the profit motive underpinning the activities of commercial debt management organisations can prospectively distort outcomes for consumers, and that a high level of regulatory scrutiny is therefore justified.

However, while we believe that it is right that not-for-profit debt adjusting and debt counselling are included in the lower risk band, we would make two specific points. Firstly, we would reiterate the comments made in our Introduction, that it is absolutely essential for a clear understanding of what constitutes debt adjusting and debt counselling to be set out, so that not-for-profit bodies can be certain about what activities will and will not be subject to regulation. We consider this issue in detail in response to Question 17.

Secondly, we would also make the point that the not-for-profit debt advice sector is not monolithic, and contains not just large actors such as Citizens Advice, StepChange Debt Charity and Money Advice Trust, but also a wide array of much smaller operators such as individual advice centres. In this context, the balance of risk to consumers potentially varies in different parts of the not-for-profit sector. While we believe that the larger not-for-profits, with substantial resources and institutional expertise, pose little risk, we question whether smaller operators may find compliance more challenging and therefore pose a slightly greater risk.

Ultimately, we do not believe this issue warrants a complete overhaul of the proposed risk regime, or that smaller operators necessarily need to be moved into the higher risk category. However, we do believe that it is important to give due consideration to the issues that will be faced by small scale not-for-profit debt advice bodies during transition, and that this perhaps raises a broader point around the need for the FCA to provide some form of intensive support to ensure they meet the requirements of the new regulatory system.

Question 4: Do you have any comments regarding our proposals for the interim permission regime?

From our perspective, the proposals for the FCA's interim permission regime appear to make sense, and represent a reasonable approach to managing the transition for firms currently operating under an OFT license. However, paragraphs 3.10 and 3.11 once again raise the issue of not-for-profit debt advice bodies and the wider question of what activities will require a permission, which we will address in response to Question 17.

<u>Question 7:</u> Do you agree with our proposal not to apply a customer function to any consumer credit activity, particularly debt advice?

We broadly agree with the FCA's decision not to apply the customer function to consumer credit activities. With respect to not-for-profit debt advice, we recognise the potential logistical challenges that would be created for some bodies if all their advisers needed to be approved, and in this context we can understand the FCA's decision not to apply the function, particularly given the concern to create a proportionate regime.

However, we do believe that standards are important within the consumer credit industry as a whole, and would therefore urge the FCA to ensure that appropriate provisions are in place in this regard, even if the customer function is not itself employed. The role of those undertaking "compliance oversight" functions in ensuring the compliance and competency of relevant staff (as touched on in paragraph 4.22) is clearly essential, and with respect to not-for-profit debt advice it will be important to ensure that the Money Advice Service's work on Quality Assurance provides a genuinely robust framework for the sector to draw upon. In addition, we would also encourage the FCA to give due consideration to whether there are certain consumer credit activities which entail particularly high risks and may require additional oversight, such as where these involve a visit to a consumer's home.

<u>Question 11:</u> Do you agree with our proposal to apply prudential standards to debt management firms only?

We support the introduction of prudential standards for debt management firms. We agree with the argument put forward in paragraphs 6.7 and 6.8, that such companies pose a higher risk to consumers due to the fact that they control clients' money prior to passing this on to creditors, and that the nature of their business means there is greater potential for them to be subject to redress proceedings. Therefore, we believe that greater prudential scrutiny of such companies is justified.

<u>Question 16:</u> Are there any provisions within industry codes that you think should be formally incorporated into FCA rules and guidance?

We believe that there is value in formally incorporating provisions from industry codes of practice into FCA rules and guidance. As an organisation, we were one of a number of bodies that worked on the development of the Consumer Finance Association's code of practice, in order to improve standards amongst its members in the payday lending industry. We feel that the involvement of consumer organisations such as ourselves, as well as Government and regulators (including the OFT itself), ultimately helped drive important steps forward, and adopting its provisions within FCA rules and guidance would help secure the gains made.

However, we would also make a broader point about the role of industry codes in general. We feel that in the longer-term these can play an important role in supplementing formal regulation,

provided that they push firms to go beyond the basic requirements set down by the FCA. We would hope that even if provisions from the codes are incorporated within FCA rules and guidance at the point of transition, they will also be the site of further improvements in standards in the future. In this context, we would envisage codes as effectively representing a sort of "gold standard" for conduct. Where codes are employed in this way, we feel that they could prospectively help to drive better outcomes for consumers, and genuinely promote best practice within the credit industry. However, we also would stress that where codes largely require signatories to simply comply with existing regulation, they add very little value, and will not complement the FCA's work in any meaningful way.

Question 17: Do you agree with the different standards that we propose to apply to different types of debt advice?

As suggested in the Introduction, one of our central concerns with regard to the FCA's proposals for reform of the consumer credit regime is the way in which the not-for-profit debt advice will be defined, and whether this could ultimately be drawn too broadly. We feel that there is an urgent need for much greater clarity on this issue.

Paragraph 8.4 states that "While we expect all regulated debt advice to be high quality, we propose to apply different rules to different types of advice, reflecting the different nature of the advice and associated risk". However, paragraph 8.5 then goes on to imply that quite a broad range of activities could prospectively fall within the scope of regulation, stating:

> Where advice is given to the borrower on the liquidation of a debt that is specific to the borrower, but the advice provider does not identify and/or recommend a particular 'debt solution' for the borrower to enter into, we propose that it should be sufficient for the advice provider to ensure that they observe the FCA's high level Principles for Business. *For example, advising a borrower on their weekly budget in order to better enable them to meet repayments of the money they owe under their credit agreement(s) as they fall due.* [Italics added]

The italicised section appears to suggest that the provision of budgeting support to clients could potentially be subject to FCA regulation, if such an activity is intended "to better enable them to meet repayments of the money they owe under their credit agreement(s)". In practice however, given that almost every UK consumer will have some form of credit obligation, it is likely that most budgeting advice will ultimately encompass the repayment of money owed under a credit agreement. Therefore, we believe that in most circumstances this definition will prospectively capture the provision of even the most generic budgeting advice.

Consequently, we are concerned that within the FCA's approach, a wide range of actors that do not offer what has traditionally been understood as debt advice could ultimately require a limited permission. For example, any organisations offering face-to-face or telephone-based budgeting services are potentially drawn into the scope of this, even where no debt solution is recommended or facilitated, while online tools offered by the likes of the Money Advice Service which allow users

to construct personalised budgets could also fall into this category. Indeed, such services are taking on particular significance right now, given the Coalition Government's wider reform of the welfare system and the introduction of Universal Credit. In this context, it has been recognised that support will be necessary to help benefit claimants to budget on a monthly rather than a weekly basis (this is highlighted in the Department for Work and Pensions' *Universal Credit Local Support Services Framework*, for example), and it is possible that all such services could require a limited permission under the above definition.

The legislation underpinning the FCA's proposed approach is set out by HM Treasury in its parallel consultation (*A new approach to financial regulation: transferring consumer credit regulation to the Financial Conduct Authority*), in a draft RAO order contained in Annex C. Part 5 article 16 of the draft RAO order amends the "by way of business" test to the effect that not-for-profit bodies undertaking "debt-adjusting", "debt-counselling" and "providing credit information services" will be subject to regulation and require a limited permission. With respect to *debt adjusting*, article 39D of the draft order states that:

> *(1) When carried on in relation to debts due under a credit agreement –*
>
> > *(a) negotiating with a lender, on behalf of the borrower, terms for the discharge of a debt,*
> >
> > *(b) taking over, in return for payments by the borrower, that person's obligation to discharge a debt, or*
> >
> > *(c) any similar activity concerned with the liquidation of a debt,*
>
> *is a specified kind of activity. [i.e. an activity subject to regulation]*
>
> *(2) When carried on in relation to debts due under a consumer hire agreement –*
>
> > *(a) negotiating with the owner, on behalf of the hirer, terms for the discharge of a debt,*
> >
> > *(b) taking over, in return for payments by the hirer, that person's obligation to discharge a debt, or*
> >
> > *(c) any similar activity concerned with the liquidation of a debt. It is a specified kind of activity,*
>
> *is a specified kind of activity.*

Equally, with respect to *debt counselling*, article 39E of the draft order states:

> *(1) Giving advice to a borrower about the liquidation of a debt due under a credit agreement is a specified kind of activity.*
>
> *(2) Giving advice to a hirer about the liquidation of debts due under a consumer hire agreement is a specified kind of activity.*

Meanwhile, article 89A of the draft order states with respect to the *provision of credit information services* that:

> *(1) Taking any of the steps in paragraph (3) on behalf of an individual or relevant recipient of credit is a specified kind of activity.*
>
> *(2) Giving advice to an individual or relevant recipient of credit in relation to the taking of any steps in paragraph (3) is a specified kind of activity.*
>
> *(3) Subject to paragraph (4), the steps in this paragraph are steps taken with a view to –*
>
> > *(a) ascertaining whether a credit information agency holds information relevant to the financial standing of an individual or relevant recipient of credit;*
> >
> > *(b) ascertaining the contents of such information;*
> >
> > *(c) securing the correction of, the omission of anything from, or the making of any other kind of modification of, such information; or*
> >
> > *(d) securing that a credit information agency which holds such information –*
> >
> > > *(i) stops holding the information; or*
> > >
> > > *(ii) does not provide it to any other person.*
>
> *(4) Steps taken by a credit information agency in relation to information held by that agency are not steps in paragraph (3). [The article then includes a final provision which defines a "credit information agency" which is not replicated here]*

Within these legislative provisions, advising borrowers on "the liquidation of a debt due under a credit agreement" constitutes a specified activity. While this could, in theory, extend to the provision of budgeting advice where this encompasses repayments on a credit agreement, this would represent an exceptionally broad interpretation of the legislation, and one that may not reflect the framers' original intent.

Consequently, we believe there is an urgent need for clarification around precisely what activities will be subject to FCA regulation. As suggested, we fear that if generic budgeting advice is ultimately covered, it will prospectively mean that a wide range of not-for-profit actors who have not previously been within the scope of regulation will require a limited permission. In our view, this would create a significant risk that many organisations will withdraw this sort of basic (but nonetheless essential) support as they seek to pull back from the regulatory perimeter. Indeed, we feel that in a situation where changes to the advice landscape (including the introduction of the Retail Distribution Review and other developments) have raised fears over the emergence of a possible "advice gap", the regulatory issues discussed here have the potential to aggravate such problems even further.

As a final point, we would also briefly raise a separate issue surrounding the terminology that surrounds the "limited permission" regime. There are concerns within the not-for-profit debt advice

sector that using the term "limited permission" to describe the FCA's regulatory approach could imply that not-for-profit services are somehow of an inferior standard compared to commercial firms who require "core" credit authorisation, rather than simply being lower risk. We believe that such concerns are warranted, and the term "limited permission" may ultimately send inappropriate messages to consumers. We would therefore encourage the FCA to develop an alternative term to describe the regime that applies to not-for-profits in order to address this.

Question 19: Do you have any comments regarding our proposed approach to peer-to-peer platforms?

We are very much in favour of greater regulation of peer-to-peer platforms. These have the potential to become a significant part of the consumer credit landscape over the next few years, and it is therefore crucial that those consumers and businesses that make use of them are afforded appropriate levels of protection. We also understand that there are important gaps in the Consumer Credit Act with respect to peer-to-peer platforms which need to be addressed.

We are therefore supportive of the creation of the new bespoke activity of "operating an electronic system in connection to lending" to cover peer-to-peer platforms, and hope that this will provide the greater legislative cover necessary. Ultimately, we would emphasise the need for an effective and robust regime for peer-to-peer platforms to be put in place when the FCA sets out its plans for the sector later this year.

With respect to prospective rules put forward in paragraph 8.20, we would add that at this stage all the suggested points sound sensible in terms of improving protections for lenders and borrowers in this area, but we will have to wait for the detailed proposals in order to form a firm view.

Question 20: Do you agree with our proposed approach to authorised firms which outsource the tracing of debtors to third party tracing agents?

We agree with the proposed approach to third party tracing agents proposed in paragraphs 8.23 to 8.27, and feel that this represents an appropriate way of dealing with tracing agents that is consistent with the Financial Services Authority's previous approach to outsourcing. In general, we expect that making firms themselves responsible for the conduct of tracing agents may well help to drive up standards, and provide strong incentives for firms to monitor agents' behaviour effectively.

Question 22: Do you have any comments regarding our proposed approach to enforcement?

Overall, we are supportive of the FCA's proposed approach to enforcement. As noted in paragraph 10.6, the FCA's powers are significantly greater than those that have been available to the OFT, and will prospectively enable the FCA to take stronger action against those firms whose actions create detriment. However, we would stress that until we have the opportunity to see how the FCA intends

to exercise these powers in practice, it is difficult to form a firm judgement on precisely how successful its approach will be.

We would also emphasise that in our view the Financial Services Authority has become more proactive in utilising its enforcement powers over the past few years, and from our perspective this has been a very positive development. We therefore believe that the FCA will need to maintain this robust approach to enforcement if its interventions in the consumer credit sector are to be effective and act as a credible deterrent.

Question 23: Do you have any comments regarding our proposed approach to complaints and redress?

The main point that we wold make with respect to the FCA's approach to complaints and redress concerns the nature of the Financial Ombudsman Service's (FOS) jurisdiction over not-for-profit debt advice providers. Paragraph 11.16 makes clear that under the new regime, such bodies will not be subject to Compulsory Jurisdiction, but instead will be able to "opt-in" to Voluntary Jurisdiction. Our view is that the ideal situation would be for all not-for-profit debt advice bodies to be subject to Compulsory rather than Voluntary Jurisdiction. We believe that as debt advice is an activity which carries particularly high stakes (with, for example, and the provision of inadequate advice potentially leading to a client losing their home), consumers should always have a right to redress through FOS if necessary, regardless of whether the advising body was a not-for-profit or commercial provider.

We recognise that, in practical terms, the immediate introduction of Compulsory Jurisdiction could create certain logistical challenges for various not-for-profit providers. Therefore, we understand that this may not be feasible in the short-term, but would encourage the FCA to work with advice providers for whom this may present difficulties with the ultimate objective of bringing all debt advice providers, whether not-for-profit or commercial, within the scope of FOS jurisdiction.

As a final note, we would also stress that debates over FOS jurisdiction further highlight the importance of drawing a clear distinction between what does and does not constitute debt advice, and we would reiterate the points we have already made in response to Question 17 in this regard.

Question 24: Do you have any comments on our proposed approach to tackling financial crime?

We are supportive of the FCA's proposed approach to tackling financial crime. In particular, we believe that the proactive activities described in paragraph 12.5, which will see the FCA gauging the adequacy of firms' policies and procedures and potentially taking action even if no crime has actually taken place, are positive, and will help drive improvements in systems and controls.

Question 27: Do you agree with our market failure analysis?

We do agree with the FCA's market failure analysis, and welcome the fact that this takes a broad view of the consumer credit market as a whole, focusing not simply on problems in the payday loan market but also addressing issues with the likes of credit card and home credit products as well. However, one point that we feel it is particularly important to emphasise is the role of product design in facilitating the inefficient use of credit by consumers.

This is touched on in paragraph 34 of the market failure analysis, which notes that credit products that can be easily rolled over and incur interest or charges (such as credit cards, payday loans and overdrafts) are particularly concerning from the perspective of consumers prone to present bias or procrastination. In our view, it is important for both regulators and industry to recognise the way in which certain features of consumer credit products (such as the capacity to make minimum payments on credit cards) actively enable consumers to use credit in an inefficient way, and indeed allow such behaviour to become entrenched within the market. We believe that this represents an important aspect of market failure within the consumer credit market, and that the industry in particular has a responsibility to deal with it moving forward.

Contact

For further information on any of the points made in this response, please contact John Davies at Credit Action, either by email at johndavies@creditaction.org.uk or by telephone on 0207 380 3390.