CONSUMER CREDIT UPDATE

AUGUST 2018

LATHAM & WATKINS

CONSUMER CREDIT UPDATE

Review of Retained Provisions of the Consumer Credit Act: Interim Report

FCA publishes Discussion Paper DP18/7

Summary

This update takes a look at the FCA's Interim Report and its initial views relating to the review of the provisions of the Consumer Credit Act 1974 (CCA), which show early signs of a more pragmatic approach to regulation than consumer credit firms have encountered historically.

Background

Before the CCA, consumer credit was regulated in the UK through a piecemeal legislative framework. The Crowther Report recommended the creation of a new legislative framework (the CCA) that would cover all credit transactions (apart from mortgages), with an emphasis on consumer protection. The Office of Fair Trading, along with the courts, had responsibility to police the CCA. European legislation (chiefly the Consumer Credit Directive (CCD)) has since influenced amendments to the CCA (such as the inclusion of specific pre-contract disclosure requirements).

Following various reviews of the effectiveness of the UK's regulators, the transfer of consumer credit oversight from the Office of Fair Trading to the FCA was completed in 2014. As part of that transition process Parliament repealed some CCA provisions and others were replaced by FCA rules.

The FCA is required by legislation to arrange for a review of the CCA and to report to HM Treasury (the Treasury) by 1 April 2019. The review must consider whether the repeal of CCA provisions would adversely affect the appropriate degree of protection for consumers. The FCA refers to this as "the statutory question."

The Interim Report sets out the FCA's initial views, and invites comments. The Interim Report is not intended to be a draft of the FCA's final report. It does not include proposed recommendations to the Treasury but indicates, in broad terms, the FCA's direction of thinking on the statutory question and related issues.

Brexit impact

The FCA assumes that substantive changes to provisions implementing requirements of European law, including the CCD, will not be possible at the current time. This is due to the fact that the FCA anticipates that EU law will remain applicable in the UK between March 2019 and December 2020 — the so-called "transitional period".

Highlights

The CCA contains some highly onerous provisions for consumer credit providers, which are heavily weighted in favour of the consumer.

Early indications are that the FCA will seek to repeal the legislation in respect of substantive pre- and post-contract disclosure requirements, replacing it with FCA rules, thus making it easier to adapt and amend over time.

FCA rules will not substitute the punitive CCA provisions relating to automatic sanctions for consumer credit firms who make mistakes, including unenforceability or disentitlement of interest or default sums. The FCA views these statutory provisions as a more effective deterrent than its own enforcement regime.

Consumer protection will remain a top priority for the regulator. But this looks to be balanced with a fairer regime for firms, which may overhaul the scope of application of the automatic sanctions regime (referenced above) such that this is limited in scope (where appropriate) to failings that cause material harm to consumers.

Next steps

- *Comments invited by 2 Nov 2018*
- *FCA will run stakeholder workshops during Sept and Oct 2018 (email CCAreview@fca.org.uk to take part)*
- *FCA is required to present its final report to the Treasury by 1 Apr 2019*

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Rights and protections (Chapter 5)

This covers:

- Credit brokerage fees
- Connected lender liability
- Variation of agreements
- Default and enforcement
- Credit-tokens
- Pawnbroking
- Withdrawal and cancellation
- Early repayment
- Termination
- Time orders
- Unfair relationships

The FCA's initial view is that the protections offered by these provisions continue to be relevant, and should remain in some form, either in legislation or FCA rules (most likely the former since repealing the law may impact the degree of consumer protection).

Information requirements (Chapter 6)

This covers:

- Pre-contract disclosure
- The form and content of agreements
- The provision of copy documents
- Post-contractual requirements, such as statements and notices

The FCA's initial view is that a framework for the provision of information by firms to customers continues to provide important consumer protection.

Whilst the FCA considers that substantive information disclosure obligations could be replaced by FCA rules, the associated sanctions, including the following, could not be replicated under the FCA's general rule-making power:

- Unenforceability of agreement without a court order
- Unenforceability of agreement during breach
- Disentitlement to interest and default sums (disentitlement)
- Criminal offences
- Breach of statutory duty

The FCA's initial view is that the "self-policing" nature of these automatic sanctions contributes significantly to ensuring appropriate firm conduct in the consumer credit sector, and protecting consumers.

In particular, unenforceability incentivises firms to comply with the form and content requirements and to provide requisite information to customers at the appropriate time. In addition, the sanction of disentitlement to interest and default sums provides an additional deterrent against non-compliance in cases where there is a particular risk of harm to vulnerable consumers.

In general, FSMA provides that a breach of an FCA rule cannot make a transaction void or unenforceable. It would not be possible to replicate unenforceability under the FCA's FSMA rule-making powers. Neither would it be possible to replicate the criminal offences under the FCA's FSMA rule-making powers.

In the absence of unenforceability, the remedy available to customers under FSMA for breach of an FCA rule would be the private law action of breach of statutory duty under section 138D FSMA. The FCA does not think that breach of statutory duty, as a substitute for unenforceability, would achieve a comparable standard of protection for consumers in the consumer credit market. Nor does the FCA think its disciplinary powers are sufficient to achieve the same outcome.

Nevertheless, the FCA's initial view is that the scope of application of the sanctions should be limited so that they are focused on breaches that are likely to cause material harm to consumers. In particular, more vulnerable customers, or those in financial difficulties. This would be in line with the original policy intention and the Crowther Report.

For example, the sanction of unenforceability could apply only if certain prescribed terms are missing, or are substantively wrong, or only if the prescribed statement or notice is not issued at all, or not remedied, within a specified period. Other breaches would attract the possibility of disciplinary sanctions, restitutionary powers, and the FSMA private right of action. However, breaches would not in themselves give rise to unenforceability, and disentitlement could be further limited to a sub-set of breaches giving rise to unenforceability. There may also be value in clarifying, in legislation, the meaning of "enforcement" to put interpretational issues (currently dealt with in case law) beyond doubt.

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Replacing CCA information requirements with FCA rules

There are a number of potential advantages to moving CCA provisions into the FCA Handbook, including:

- Less complexity: currently, navigating the law is challenging.
- Opportunity to review information requirements: it would give the FCA the opportunity to review in detail the substance of the information requirements so as to provide an appropriate level of consumer protection without imposing a disproportionate burden on firms.
- Simpler to amend in the future: having the information requirements in the FCA Handbook would allow for quicker and more agile responses.

Against this background, the FCA's initial view is that it would be desirable to replace the obligations to provide information in these CCA provisions with FCA rules.

If the information requirements contained in CCA provisions and regulations were replaced with FCA rules, one option would be to retain the related CCA provisions on the consequences of non-compliance. There would need to be consequential changes to the CCA provisions that contain the sanctions for non-compliance to apply them to breaches of FCA rules.

For example, section 77 of the CCA could be repealed and replaced, with the exception of section 77(4) on unenforceability. This subsection would remain in the CCA, but would need to be amended to apply the sanction to breaches of FCA rules.

This could apply to a large majority of CCA information requirements, including those in regulations (but see also other options for sanctions).

Issues identified with information requirements

The Interim Report considers stakeholders' concerns that the detailed nature of the information requirements is inflexible (overly prescriptive in content and form), imposes unnecessary constraints on firms, and leads to poor outcomes for consumers. On the whole, the FCA considers that the required information does not seem excessive. However, the FCA also considers that amending or reducing some requirements might help.

Prescribed wording

There is a chance that some of the prescribed wording mandated by the CCA may be amended by the FCA in time. The FCA thinks that in most cases the wording appears to be reasonably clear and concise. However, the FCA also considers that amendments to some of the wording could make it more relevant and readily comprehensible for customers in different situations.

The FCA also thinks that the form requirements are generally minimal and common-sense, although it may be possible to simplify or improve aspects of these.

Level of prescription in relation to default and arrears notices

The FCA thinks that the level of prescription may be justified given the greater potential for harm to customers receiving these notices. Nevertheless, changes might lead to better outcomes for customers and reduced burdens on firms.

Connected lender liability

Under section 75 (and 75A) of the CCA, a creditor is jointly and severally liable in certain circumstances for a supplier's breach of contract or misrepresentations in relation to goods or services. This is most commonly thought of as the protection you get on credit card purchases.

The FCA does not consider that it could use its general rule-making power under FSMA to make a rule that replicates the meaning and effect of section 75.

The FCA notes that there is wide agreement that section 75 provides a strong consumer protection measure that consumers are relatively familiar with, and often use. It can give consumers the confidence to buy from unknown suppliers, or those based online only or abroad. The FCA also notes that this protection drives business for credit providers as it encourages consumers to use credit cards over other means of payment. There is helpful case law on the interpretation of section 75 that would be lost if the FCA sought to replace it. The FCA's initial view is that sections 75 and 75A should be retained in legislation.

However, the FCA thinks there is a case for considering the issues identified with sections 75 and 75A, to ensure that they provide an appropriate level of consumer protection without imposing undue or disproportionate burdens on firms, and to clarify or update aspects.

Variation of agreements

Variations arise if the creditor or owner amends a regulated agreement under a power contained in the agreement. In such a case, before the variation can become effective, the creditor or owner must provide notice of the variation to the customer in the prescribed manner.

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The FCA's initial view is that section 82(2) should remain in the CCA, but with the associated information requirements being repealed and replaced by FCA rules.

Notices in relation to enforcement

The CCA provides that a creditor or owner is not entitled to take certain enforcement action in relation to a regulated agreement unless notice is given to the customer in the prescribed manner.

The FCA's initial view is that this should remain in the CCA.

Unauthorised payments and credit-tokens

The new Payment Services Regulations 2017 (PSRs) include provisions governing liability for unauthorised payment transactions within their scope. These provisions are currently dis-applied in some cases for CCA-regulated agreements. The FCA's initial view is that there may be merit in moving towards a uniform, consistent regulatory regime in relation to unauthorised payment transactions, whether or not they are covered by a credit line provided under a CCA-regulated agreement.

The FCA considers that the overall level of protection is broadly comparable, and the advantages of creating a more unified regime suggest that it would be appropriate to replace sections 83 and 84 of the CCA with regulations 75 and 76 of the PSRs where a CCA-regulated agreement is also an agreement for payment services.

However, section 83 should be retained in respect of CCA-regulated credit facilities that do not involve the provision of payment services within Part 7 of the PSRs.

Withdrawal and cancellation

The FCA's initial view is that the provisions relating to withdrawal and cancellation in sections 66A and 67 to 73 should remain in the CCA on the grounds that their repeal would adversely affect the appropriate degree of consumer protection.

Early repayment

Section 94 of the CCA entitles the debtor to settle a regulated credit agreement ahead of time, either in full or partially, by giving notice to the creditor and making the necessary payment to discharge their debt, less any rebate of charges. The debtor may also be liable, in certain limited cases, to pay compensation to the creditor.

The FCA's initial view is that elements of the early settlement provisions should remain in the CCA in order to preserve the coherence of the regulatory regime. There may, however, be merit in considering transferring the associated information requirements into FCA rules, so that they can more easily be kept up to date.

Unfair relationships

The court has extensive powers under the CCA to re-open credit agreements if it determines that there is an unfair relationship between the creditor and the debtor arising out of the agreement, or the agreement taken together with any related agreement.

Section 140A of the CCA bears some similarities to both Principle 6 of the FCA's Principles for Businesses (which requires a firm to pay due regard to the interests of its customers and treat them fairly), and some of the conduct rules in CONC.

A contravention of Principle 6 would be taken into account by the Financial Ombudsman Service when deciding what is fair and reasonable and what redress to award for the purposes of determining a complaint. A breach of Principle 6 may also form the basis of the exercise of the FCA's power to require a firm to take remedial action, including the payment of redress, or requiring restitution (although a formal consumer redress scheme under section 404 FSMA cannot be used for breaches of the Principles, unless PRIN is amended to make the Principles actionable in court).

In comparison, the court has a very broad discretion under the CCA to order a creditor (or an associate or former associate, who may not necessarily be an authorised person) to take the steps described in section 140B on an application made by a debtor or a surety. This applies if the court considers that that the particular relationship between the debtor and the creditor is unfair in the individual circumstances of the case.

The broad power to re-open and recalibrate an individual contractual relationship between a debtor and a creditor, if restoring a fair balance between the parties is appropriate, has been a key protection in consumer credit regulation for a number of years. The FCA's initial view is that it does not consider that it would be appropriate, from a consumer protection perspective, to remove the ability of a debtor or surety to ask the court for relief from the consequences of an unfair relationship.

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Summary Findings

Extent to which replaceable	Category	Section of CCA	Subject
Provisions replaceable in whole	n/a	55C	Copy of draft credit agreement
		77B	Statement of account on request (fixed-sum credit)
		176	Service of documents
		176A	Electronic transmission of documents
Provisions replaceable in part: obligation to provide information could be replaced but not the associated sanctions	Unenforceability without a court order	55	Form and content of pre-contractual information
		60	Form and content of contractual information
		61	Signing of agreement
		61A, 61B, 62, 63	Copy of agreement
		64	Information about cancellation rights
		82(2) to (6B)	Modifying agreements
	Unenforceability during non-compliance	77	Statement of account and copy agreement on request (fixed-sum credit)
		77A	Periodic statements of account (fixed-sum credit)
		78	Statement of account and copy agreement on request / periodic statements (running-account credit)
		79	Statement of account and copy agreement on request (hire)
		85	Copy agreement on issue of new credit-token
		86B	Notice of sums in arrears (fixed-sum credit)
		86C	Notice of sums in arrears (running-account credit)
		86E	Notice of default sums
		97	Settlement statement
	Disentitlement to interest and default sums	77A	Periodic statements of account (fixed-sum credit)
		86B	Notice of sums in arrears (fixed-sum credit)
		86C	Notice of sums in arrears (running-account credit)
		86E	Notice of default sums

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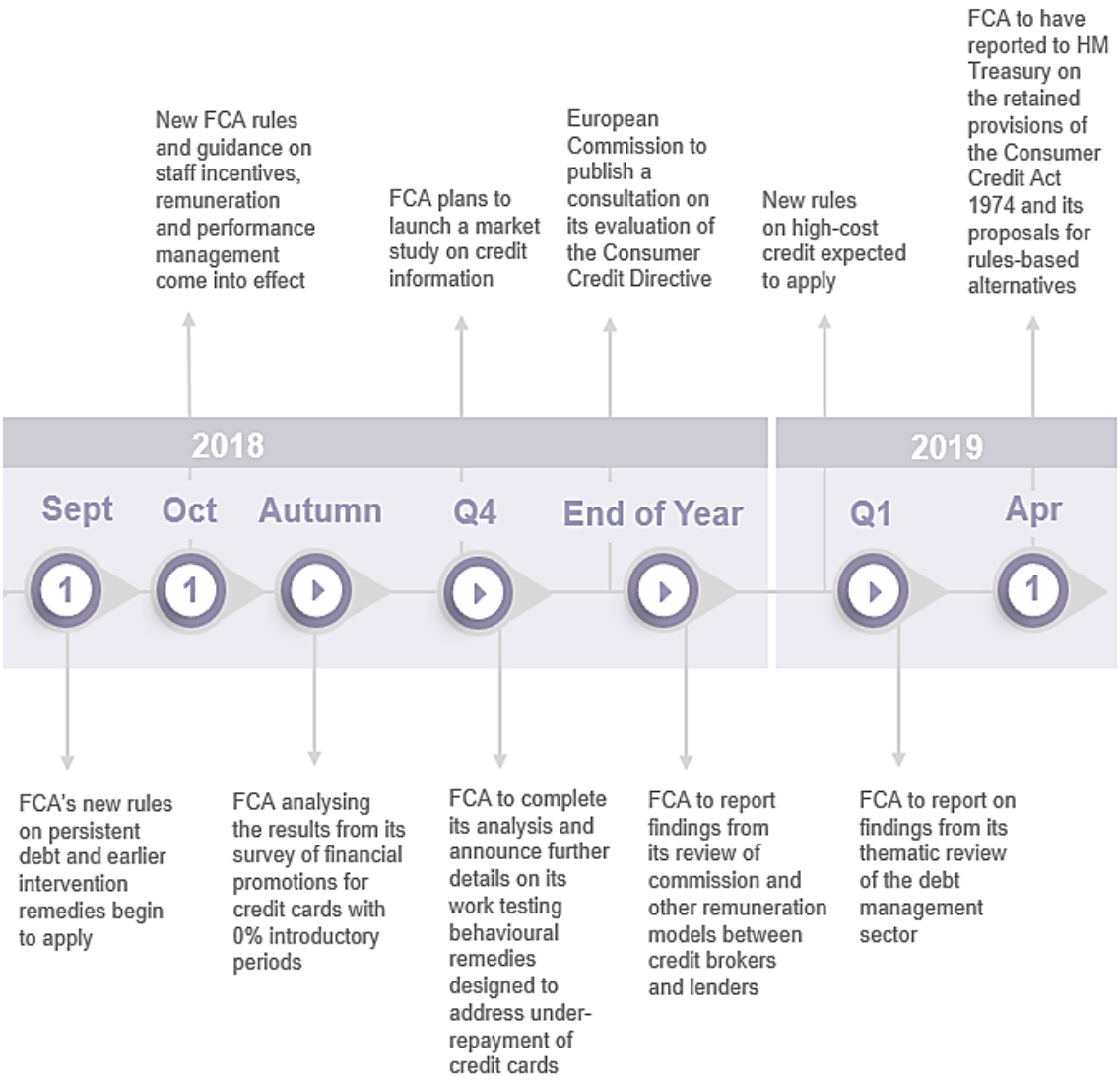
Timeline — expected consumer credit developments



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