



HM TREASURY

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Department for Business  
Innovation & Skills

# A new approach to financial regulation:

consultation on reforming the consumer  
credit regime

December 2010





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# Foreword

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Ensuring the financial system delivers for consumers and businesses is central to the Government's agenda for balanced, sustainable economic growth. Empowered consumers and successful businesses underpin thriving competitive markets. That is why action to strengthen consumer protection and to ensure a proportionate regulatory burden for business is core to the Coalition's programme for Government.

In July, as part of a major programme to reform the institutional framework for financial regulation in the UK, the Government announced proposals for the creation of a strong independent consumer protection and markets authority (CPMA). As part of this, the Government announced its intention to consult on the merits of transferring responsibility for consumer credit from the Office of Fair Trading to the new CPMA, thereby bringing consumer credit into the same regulatory regime as other retail financial services.

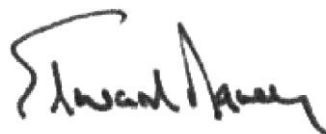
We see a real opportunity to improve the way consumer credit is regulated and to create a simpler, more responsive regime. The Government believes that bringing responsibility for consumer credit within a legal framework based on the model set out in the Financial Services and Markets Act could deliver stronger protections for 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.

We recognise, however, that a reform of this magnitude is likely to represent a significant change for many firms not currently authorised by the Financial Services Authority. Any new consumer credit regime must be flexible and proportionate, reflecting the diverse nature of the sector. We also recognise that any process to reform consumer credit regulation would take time and that further detailed consultation on the regime and its implementation would be needed to ensure improved outcomes for consumers are achieved, while minimising costs to business and any potential disruption to lending activity.

We are committed to ensuring that the decision on bringing consumer credit into the scope of CPMA regulation reflects the needs of consumers and businesses, particularly those that are currently subject to consumer credit regulation. We welcome your views on these important proposals.



Mark Hoban  
Financial Secretary to the Treasury



Edward Davey  
Minister for Consumer Affairs





# Executive summary

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## Opportunity for change

The Government recognises the importance of ensuring that the consumer credit regime is fit for the future, flexible and able to keep up with a fast-paced, innovative market. The current division of responsibility for retail financial services between two regulators – the Office of Fair Trading (OFT) and the Financial Services Authority (FSA), with two very different regulatory regimes – can result in outcomes that are sub-optimal for consumers and firms. As part of its wider reform of the financial regulatory architecture, the Government is creating a new consumer protection and markets authority (CPMA – this is a working title), with a clear remit for consumer protection. This provides an ideal opportunity to take a fresh look at the way in which consumer credit is regulated and by whom, and to create a more responsive and dynamic regime.

This consultation sets out the Government's proposal to transfer responsibility for consumer credit from the OFT to the new CPMA. The proposal for reform is also set within the context of possible wider institutional changes to the competition and consumer regimes. The Public Bodies announcement in October<sup>1</sup> included proposals to merge the competition functions of the OFT with the Competition Commission and reallocate some consumer functions to other bodies. As such, this consultation takes account of the possibility that the OFT may no longer be operating in its current form in the future.

In delivering reform, the Government wants to enhance clarity for consumers and businesses and increase confidence in consumer credit regulation. Its ambition is to create a world-class regulatory regime that keeps pace with the dynamic nature of this market; responds to actual or potential gaps in consumer protection; and places a manageable regulatory burden on business. The key objectives that the Government is aiming to achieve through these proposals are:

- clarity, coherence and improved market oversight;
- effective and appropriate consumer protection, including through a responsive and flexible framework;
- opportunities for simplification and deregulation; and
- a proportionate and cost effective regime.

An overview of the consumer credit market, an analysis of the weaknesses the Government perceives in the current framework, and a detailed discussion of the objectives for reform are set out in Chapter 1.

## Options for reform

The Government's proposals for reform reflect not only the opportunity provided by the creation of the CPMA, but also parallel work relating to the future of the competition and general consumer functions of the OFT. The Government is therefore seeking respondents' views on a choice between:

- Option 1: a regulatory regime for consumer credit under the CPMA within a legal framework based on the model set out in the Financial Services and Markets Act 2000 (FSMA) and therefore consistent with the regulation of other retail financial services; or

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<sup>1</sup> [http://www.cabinetoffice.gov.uk/newsroom/news\\_releases/2010/101029-quango.aspx](http://www.cabinetoffice.gov.uk/newsroom/news_releases/2010/101029-quango.aspx)

- Option 2: a specific consumer credit regime based on the Consumer Credit Act 1974 (CCA).

Chapter 2 analyses these options based on the objectives for reform, outlining that the Government's preferred option is option 1. The Government believes that this option would ensure clearer accountability and coherence by bringing the regulation of all retail financial services under one regulatory regime. Furthermore, the CPMA will have a strong mandate for consumer protection and these reforms would provide it with the means to take a stronger market oversight role. Replacing the statutory basis of consumer credit regulation with a rules-based approach would also provide for a more flexible and responsive regime.

The development of CPMA rules for consumer credit would provide an ideal opportunity to consider a systematic overhaul of the current regime and, subject to constraints such as the Consumer Credit Directive, to identify opportunities for the removal of unnecessary burdens through simplification and deregulation, alongside improvements in consumer protection.

## **Delivering an effective and proportionate approach**

Chapter 3 considers how a new consumer credit regime, based on a model of integration into a FSMA-style framework, could achieve an effective and proportionate regulatory approach.

The Government envisages that the CPMA could consider applying certain core elements of the current FSMA regime to consumer credit firms. But it also recognises that reforms must be designed to mitigate a disproportionate impact on smaller firms, and minimise the risk of increased market exit, reduced competition, a restriction in the supply of regulated credit or a higher incidence of unauthorised trading. Chapter 3 sets out the Government's views on how a CPMA regime for the consumer credit sector could take these issues into account. The detail of such a regime would, however, be for the CPMA to design, and the latter's rule-making process would generally include detailed consultation and cost benefit analysis.

## **Ensuring an effective transition to a new regime**

The Government recognises the significant challenge that undertaking a reform of this magnitude would entail, and that a transition period of several years would be needed. The Government is committed to ensuring that high quality consumer credit regulation is retained throughout any transition, and to minimising costs, complexity, disruption and uncertainty. Chapter 4 sets out how the Government would aim to address key issues relating to transitional arrangements if the decision were taken to transfer consumer credit responsibility to the CPMA. These include the application of a new regime to existing agreements and consumer credit licences.

## **Next steps**

The Government's preferred option is to transfer responsibility for consumer credit from the OFT to the CPMA on the basis of a model of full integration into a FSMA-style regime (option 1). If a decision is made to proceed with this proposal following this consultation, appropriate provision could be included in the forthcoming Bill on wider reform of the institutional framework for financial regulation in the UK. The FSA would issue further consultations on the detailed design and implementation of the new regime, drawing on the experience and expertise of the OFT. If a decision is made to retain the CCA regime, the Government would consider the most appropriate regulatory authority for this regime following the conclusion of wider work on the future of the competition and general consumer functions of the OFT, and would issue a further consultation on this if necessary. Further information on how to respond, next steps and devolved issues is set out in Chapter 5.

# 1

## The case for reform of the consumer credit regime

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**1.1** Consumer credit is vital to the UK economy. It funds the purchase of goods and services and provides people with greater flexibility with their spending. A healthy consumer credit market which serves businesses and consumers well is central to economic recovery and growth; and a key element of a healthy consumer credit market is effective regulation.

**1.2** The Government believes that the current division of responsibility for retail financial services between two regulators – the Office of Fair Trading (OFT) and the Financial Services Authority (FSA), with two very different regulatory regimes – may lead to confusion and outcomes that are sub-optimal for consumers and firms. The Government wants to see improved regulation contribute to a more efficient and effective credit market in the UK.

**1.3** This chapter provides an overview of the consumer credit market and its regulation, highlights the main issues with the current system that the Government wants to tackle and sets out the objectives for reform.

### Wider institutional reform and opportunity for change

**1.4** The July HM Treasury consultation document *A new approach to financial regulation: judgement, focus and stability* outlined proposals to reform the institutional framework for financial regulation in the UK<sup>2</sup>. The Government set out its intention to create a Financial Policy Committee in the Bank of England; a new Prudential Regulation Authority as a subsidiary of the Bank of England; and a strong independent consumer protection and markets authority (CPMA – this is a working title). Through this consultation, the Government sought views on a range of issues relating to the proposed legal and institutional framework, and a further consultation setting out detailed policy and legislative proposals will be published by the Treasury in early 2011. The Government believes that this presents an ideal opportunity to consider the way in which consumer credit is regulated and by whom.

**1.5** The CPMA will be a focused conduct of business regulator with the primary objective of ensuring confidence in financial services and markets, with a particular focus on protecting consumers and ensuring market integrity. In taking over part of the FSA's current role, the CPMA will take a tougher, more proactive and more focused approach to regulating conduct in financial services and markets than has the FSA. The Government views the creation of the CPMA as an opportunity to review how consumer protection is enshrined in the Financial Services and Markets Act 2000 (FSMA) and what changes may be needed to update or strengthen the regime. As part of this, this consultation considers whether outcomes for both consumers and firms might in general be enhanced by moving consumer credit regulation<sup>3</sup> to sit alongside that of other retail financial services<sup>4</sup>.

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<sup>2</sup> [http://www.hm-treasury.gov.uk/d/consult\\_financial\\_regulation\\_condoc.pdf](http://www.hm-treasury.gov.uk/d/consult_financial_regulation_condoc.pdf).

<sup>3</sup> Additionally, following a consultation initiated by the previous administration, the Government is also considering the specific question of whether second charge mortgage regulation should be transferred to the FSA. This question is being considered independently of the wider consultation on consumer credit regulation.

<sup>4</sup> 'Retail financial services' are such services as current accounts, payments, personal or mortgage loans, savings, pensions, investments or insurance products, when they are provided to individual customers, including retail investors.

**1.6** The Government is also conducting a review of consumer credit and personal insolvency. A call for evidence was issued on 15 October and closed on 10 December 2010, focusing primarily on matters that may need urgent attention; in particular at forms of credit that may tempt people unnecessarily into debt or make it particularly difficult for individuals to manage their finances. Depending on the outcome of this review, it may be that some matters raised could be considered as part of the reforms that would take place should a decision be made to transfer responsibility for consumer credit regulation.

**1.7** This consultation should also be considered in the context of the Government's Public Bodies Bill announcement and the statement by the Secretary of State for Business, Innovation and Skills on 14 October 2010, and their implications for the future of the OFT. As part of a wider review, the Government will be publishing consultations in early 2011 to determine the future location of certain competition and general consumer functions that currently fall to the OFT.

## **A rapidly changing consumer credit market**

**1.8** The UK's consumer credit market is well established, diverse and one of the largest in the world. The use of unsecured credit has grown significantly in the last two decades<sup>5</sup>. In the first nine months of 2010, almost £131 billion was lent in unsecured credit, an amount which exceeded that for new secured lending (i.e. mortgages) by almost £30 billion over the same period. Today, around two thirds<sup>6</sup> of all households borrow money, up from just under half in 2002<sup>7</sup>. Furthermore, there is a wide and diverse range of consumer credit products including credit cards, unsecured personal loans, home credit, cheque cashing, pawnbroking, payday loans, overdrafts and retail finance. This consultation is an important opportunity to ensure that the consumer credit regulatory regime is fit for the future, flexible and can adapt to further changes in the market.

**1.9** Regulation should facilitate the right outcomes for consumers while being proportionate to the risks posed. The subprime credit market<sup>8</sup> has seen strong growth in recent years. This has been partly due to difficulties in obtaining mainstream credit during the economic downturn as consumers' creditworthiness fell and mainstream lenders tightened credit conditions, and the emergence of new business models. The number of people using payday loans, for example, has quadrupled in the last four years to 1.2 million<sup>9</sup>, while the number of pawnbroking outlets is estimated to have increased from 800 in 2003 to 1,300 today<sup>10</sup>. This has been accompanied by a rise in the numbers of consumers struggling to repay their debts<sup>11</sup>. This has led to increasing demand for debt advice and support; for example, consumers have entered into approximately 600,000 debt management plans<sup>12</sup>, which manage around £9 billion of consumer payments<sup>13</sup>.

**1.10** The Government is looking more widely at the way in which consumers make the decision to take out unsecured credit (including through the consumer credit and personal insolvency

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<sup>5</sup> The amount borrowed in unsecured credit in the third quarter of 2010 is nearly two and a half times higher in real terms than the same period in 1987. Source: Bank of England and Office of National Statistics.

<sup>6</sup> Data for 2006-8. Source: Wealth and Assets Survey and Office of National Statistics.

<sup>7</sup> *Over-indebtedness in Britain*, Kempson (2002).

<sup>8</sup> Made up of subprime retail credit, home credit, credit union loans, payday loans and pawnbroking. See also *Review of high-cost credit*, Office of Fair Trading, June 2010, [http://www.offt.gov.uk/shared\\_offt/reports/consumer\\_credit/High-cost-credit-review/OFT1232.pdf](http://www.offt.gov.uk/shared_offt/reports/consumer_credit/High-cost-credit-review/OFT1232.pdf); scope of pawnbroking, payday and other short-term small sum loans, home credit and rent-to-buy credit.

<sup>9</sup> *Keeping the Plates Spinning*, Consumer Focus study, August 2010, <http://www.consumerfocus.org.uk/assets/1/files/2010/02/Keeping-the-plates-spinning.PDF>.

<sup>10</sup> *Pawnbroking Customers in 2010: A survey – A report to the National Pawnbrokers Association*, Bristol University, August 2010, <http://www.bris.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1005.pdf>.

<sup>11</sup> According to the British Household Panel Survey, between 1995 and 2005, debtors who encountered financial problems remained relatively stable at 10%. Since then, the proportion has increased to around 15%.

<sup>12</sup> Debt management plans are a non-statutory method which can assist individuals who are in debt and unable to meet their commitments to have their debts assessed and have a monthly repayment deal brokered with their creditors.

<sup>13</sup> [https://academic.mintel.com/sinatra/oxygen\\_academic/new\\_reports/&list=latest\\_items/display/id=479887&set\\_access\\_filter=unl-ZIE](https://academic.mintel.com/sinatra/oxygen_academic/new_reports/&list=latest_items/display/id=479887&set_access_filter=unl-ZIE).

review) and recognises the importance of ensuring that regulation is able to keep up with market innovation.

## How consumer credit is regulated

**1.11** Consumer credit regulation is an area of considerable complexity and is estimated to impose a regulatory burden on business and consumers of approximately £235 million a year<sup>14</sup>.

**1.12** The OFT is the licensing authority and main enforcement body for regulated consumer credit (including personal loans, credit card lending and the provision of goods and services on credit as well as related activities such as debt collection and debt management) under the Consumer Credit Act (CCA) 1974, substantially amended both in 2006 and earlier this year by the implementation of the Consumer Credit Directive (CCD)<sup>15</sup>. The CCA is a broad Act governing most forms of consumer credit, consumer hire and debt related activity, and is supplemented by a range of subordinate legislation. Its objective is to protect consumers through the control of traders involved in credit and their transactions. It provides for core consumer protections, extended by the CCD (see Annex A). The wide scope of the CCA means that many licensees are not financial services businesses themselves, but provide access to credit, allow payment in instalments for goods and services, or provide ancillary services such as debt advice or credit reference information. The licensed population therefore includes high street retailers, car dealers and suppliers of general goods and services.

**1.13** Oversight of the CCA forms part of the OFT's broader mission to make markets work well for consumers by promoting and protecting consumer interests throughout the UK and ensuring that markets are fair and competitive<sup>16</sup>. Certain other pieces of related legislation also form part of the consumer credit regime, including the Bills of Sale legislation (England and Wales only) and Part 8 of the Enterprise Act 2002. In addition to consumer credit regulation, the OFT also discharges its functions under other legislation covering competition policy and general consumer protection legislation, including the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) and the Consumer Protection from Unfair Trading Regulations 2008 (CPRs).

**1.14** The OFT shares responsibility for enforcement of the CCA regime with local authority Trading Standards Services and the Department of Enterprise, Trade and Investment in Northern Ireland (DETINI), which have powers to prosecute certain offences under the CCA and general consumer law such as the CPRs. Trading Standards Services also undertake a wider role, monitoring compliance and providing intelligence and evidence to the OFT on consumer credit firms operating in their locality, investigating consumer complaints, and providing advice to businesses offering credit and debt services to consumers. Trading Standards Services collaborate on a regional basis in the delivery of the specialist Illegal Money Lending enforcement teams in England, Scotland and Wales.

**1.15** Self-regulation is also a part of the regulatory regime for consumer credit, and in many instances can provide a preferable alternative to regulation. The self-regulatory Lending Code<sup>17</sup> applies to banks, credit card companies and building societies in their dealings with consumers, micro-enterprises<sup>18</sup> and charities with an annual income of less than £1 million. The code sets minimum standards of good practice in relation to loans, credit cards, charge cards and current

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<sup>14</sup> See Impact Assessment.

<sup>15</sup> The regulations come into force on 1 February 2011, although from 30 April 2010 firms can comply with the regulations as soon as they are able. The financial thresholds concerning the scope of the CCD and those affecting the early repayment provisions are due for review by the European Commission in 2013. Certain other aspects of the CCD where Member States have some flexibility in implementation will also be monitored by the Commission.

<sup>16</sup> <http://www.of.gov.uk>.

<sup>17</sup> <http://www.lendingstandardsboard.org.uk/docs/lendingcode.pdf>.

<sup>18</sup> A micro-enterprise is defined as a business that employs fewer than 10 persons and has a turnover or annual balance sheet that does not exceed two million euro.

account overdrafts. Compliance is monitored and enforced independently by the Lending Standards Board, funded by industry subscribers. A revised code is expected to be launched at the end of March 2011. As announced by the British Banking Association (BBA) Taskforce report *Supporting UK Business*, the new code will include the commitments made by the BBA in June 2010<sup>19</sup> to cover small businesses or micro-enterprises. Other parts of the consumer credit industry are also covered by codes, such as the Finance and Leasing Association Lending Code and the Debt Managers Standards Association Code. These are typically overseen by the relevant trade associations themselves rather than an independent body.

**1.16** Of the approximately 96,000 firms regulated by the OFT, an estimated 16,000 are also authorised by the FSA for financial services activities regulated under FSMA<sup>20</sup>. The current FSMA framework, which the Government has announced will form the basis of the CPMA's powers and functions, includes a number of elements that represent a different approach to the CCA regime, as highlighted in Box 1.A.

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<sup>19</sup> Available at <http://www.bba.org.uk/media/article/Banks-are-open-for-business-and-will-play-their-full-part-in-financing/press-releases/>.

<sup>20</sup> Many appointed representatives – who can conduct regulated activities on behalf of an FSA-authorized firm but are not themselves authorised – also hold a consumer credit licence. The potential overlap between OFT and FSA regulation is likely to be significantly higher if appointed representatives are included; preliminary estimates suggest this could be in the range of 23,000-52,000 firms.

### Box 1.A: Key differences between the CCA and FSMA regimes

- **Rule-making and enforcement:** Under the CCA regime, responsibility for rule-making and enforcement are divided. OFT has some powers to issue guidance, but rule-making authority largely rests with Parliament. The OFT is the main enforcer of the CCA, together with local Trading Standards Services and DETINI. Under the FSMA regime, the FSA is responsible for consulting on, making and enforcing rules. The FSMA enforcement regime currently provides a broader range of specific sanctions than the CCA regime, including powers to impose significant fines, and to require consumer redress schemes to compensate consumers. The CCA provides powers for the OFT to refuse or revoke a licence, and to impose tailored requirements on firms, with fines of up to £50,000 per breach of a requirement.
- **Consumer rights and redress:** The CCA regime creates a number of specific rights for individual consumers and provides in certain circumstances that non-compliance will render the agreement unenforceable except by court order<sup>21</sup>. Consumers may take legal action as a result of breach of an FSA rule (unless the rule itself precludes that possibility). Both regimes provide access to independent dispute resolution via the Financial Ombudsman Service. The FSMA regime, unlike the CCA, also includes provision for consumer redress, both through FSA sanctions and through access to the Financial Services Compensation Scheme in case of insolvency.
- **Market oversight:** FSMA gives the FSA an explicit responsibility for oversight of markets. The CCA places a duty on the OFT to advise Ministers on developments in markets and the working of the CCA. OFT also has wider powers to undertake market studies and make market references to the Competition Commission. However, the regime does not grant a single authority responsibility for market oversight.
- **Supervision of firms:** Generally, FSA authorised firms have a regular supervisory relationship with the regulator. Under the CCA regime, in contrast, the regulator's contact with firms is intelligence and issue-led. Regular reporting requirements on most FSA-authorized firms provide a comprehensive picture of regulated activities. While CCA provides for information gathering powers, regular reporting by all licence holders is not required, so there is currently no comprehensive view of activity across all relevant markets.
- **Business applications:** Generally applications for FSA authorisation are more complex and must be supported by more documentation than applications for an OFT licence. The FSA will consider matters such as whether the firm holds sufficient capital reserves or professional indemnity insurance cover, and while both regimes consider the likely effectiveness of a firm's compliance structures, the FSMA regime also requires the provision of information about a firm's business plan and accounts.

Key features of the CCA and FSMA regimes are outlined in more detail at Annex B.

<sup>21</sup> Certain provisions before amendments made by CCA 2006 provided for unenforceability without a power for the court to set it aside.

## Why reform the way consumer credit is regulated?

1.17 Notwithstanding previous consideration of the division in regulation of consumer credit and other financial services<sup>22</sup>, the Government believes that there remains a fundamental weakness caused by the split in responsibility for retail financial services between the CCA and FSMA regimes. The creation of the new CPMA therefore presents a real opportunity to reconsider the way in which consumer credit is regulated and by whom, and to address the following continuing limitations and problems:

- **Accountability for some objectives relating to retail financial services is split** between the OFT, FSA, Trading Standards Services, specialist Illegal Money Lending teams, DETINI, the Department for Business, Innovation and Skills and HM Treasury. This can be made to work most of the time, helped by concordats between the relevant organisations, and can indeed deliver benefits. But for the market as a whole, no one organisation is clearly accountable for performance against a set of clear statutory objectives.
- **Lack of coherence in consumer protection and market oversight:** The split in responsibility makes it difficult for regulators to take a strategic view of priorities across the entire retail financial services sector. Decisions are driven by different legal duties and powers of individual regulators. Having two regulatory regimes for what is often from the consumer's perspective a single product or service (such as personal current accounts with overdrafts or flexible mortgages) can result in different rights and divergence in protection for personal and small business consumers. Challenges may also arise in developing a coherent policy response to emerging consumer protection issues that span the two regimes, for instance the recent debate surrounding the right of 'set-off'. This is a practice whereby financial institutions can use money available in one account to repay an outstanding debt; currently, however, treatment of customers regarding credit agreements is covered by the Lending Code and regarding bank accounts is regulated by the FSA.
- **Confusion and duplication:** The separate regulation of consumer credit and other retail financial services can be incongruous and confusing for firms and consumers. For example, payment protection insurance can be marketed alongside personal unsecured loans, and may be financed by credit, but the insurance and the credit elements are subject to different forms of regulatory scrutiny. The regulatory overlap means that some firms have to seek authorisation from two bodies (even across single products) and meet two separate sets of rules. Dual regulation of firms that are both FSA authorised and OFT licensed can lead to duplication of costs in terms of compliance and supervision; some trade bodies, for instance, have highlighted that the current division can give rise to the potential for overlapping data requests, investigations and communication, as well as duplication of administrative burdens. This may also lead to risks of regulatory creep if businesses find it more convenient to apply the highest level of regulation to their activities, even if some of these may not be directly subject to the regulation applied.
- **Too reactive and insufficiently flexible:** The fast pace at which the UK credit market has developed in recent years, combined with the dynamic nature of product development, has not always been matched by changes to the legislative and regulatory framework. The 2006 CCA, which significantly reformed the 1974 CCA, was the first major overhaul of consumer credit legislation for 32 years. Furthermore, many requirements of the CCA

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<sup>22</sup> For example, a footnote to the 2005 Hampton Report queried whether regulation of consumer credit should pass to the FSA. The previous Government announced in March 2006 that in the light of recent and ongoing changes to the consumer credit regime, it did not propose additional reforms of the regime. From 2006 to 2009, the OFT and FSA published Joint Action Plans on matters of joint regulatory interest, and in 2009 a Memorandum of Understanding setting out a new framework for ongoing cooperation on financial services.



regime are enshrined in the Act itself, meaning that primary legislation can be needed even to make relatively small changes<sup>23</sup>. For example, the CCA imposes requirements on lenders as to what information should be provided to consumers in a particular circumstance. While the precise detail is generally in secondary legislation, changing which consumers receive information and when will often require amendments to primary legislation. The FSMA model, in contrast, could allow for more flexible approaches to informing consumers. Concerns have also been raised that the consumer credit licensing system has not worked sufficiently well to protect consumers from abuse by some financial service providers. In many cases, the OFT lacks direct powers to outlaw emerging unfair practices across the board, relying on the deterrent effect of individual enforcement cases which can be subject to lengthy appeal. The FSMA regime, in contrast, is characterised by more proactive supervision.

- **Deterrent to effective deregulation:** The general requirement for primary legislation to amend the CCA makes it very cumbersome to deregulate. This has meant that even simple changes, such as the uncontroversial change to remove the requirement to send information to people who are no longer at an address, are still outstanding. Reframing the regulatory regime for consumer credit offers the potential for wider deregulation (subject to EU constraints) which could deliver benefits for both businesses and consumers and would provide for more rapid and effective resolution of unintended effects in future.

#### **Box 1.B: Consultation questions**

1. Do you agree with this assessment of the consumer credit market?
2. Is this a fair assessment of the problems caused by the way in which consumer credit is currently regulated and issues that may arise as a result of the split in responsibility for consumer credit and other retail financial services?
3. The Government would welcome further evidence relating to the consumer credit regime, including in particular:
  - the types of risks faced by consumers in consumer credit markets;
  - key provisions for consumer protection under the current regime and their effectiveness in securing appropriate outcomes for consumers; and
  - the incidence of regulatory duplications or burdens on firms and/or inconsistent regulation of similar types of business.

## **Policy objectives**

**1.18** The Government's ambition is to create a world-class regulatory regime that keeps pace with a dynamic consumer credit market; responds to actual or potential gaps in consumer protection; and places a proportionate regulatory burden on business. Any new consumer credit regime should be flexible enough to respond to innovation in the consumer credit market, yet give as much certainty as possible to both industry and consumers. In considering whether or not to proceed with the transfer of consumer credit regulation to a FSMA-style regime, the Government will therefore be guided by the following objectives:

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<sup>23</sup> Except where the change is required by EU law.

- **Clarity, coherence and improved market oversight:** A new regime should provide greater regulatory coherence, a single point of accountability and ensure consistent treatment of similar firms and products. The Government wants more compatible rules, approaches and terminology to be applied to similar or competing products, including those that currently span the two regimes. The regime should be properly resourced and have the necessary powers to secure better market information and ensure earlier identification of risks to consumers and market confidence. The Government also wants to reduce the compliance and administration burdens for firms currently regulated under different regimes by both the FSA and the OFT.
- **Effective and appropriate consumer protection, including through a responsive and flexible framework:** Consumer protection is at the core of consumer credit regulation. The Government wants a regime that at least maintains, and where possible strengthens, overall protection for consumers, including small businesses. This does not mean eliminating all risk, or removing responsibility from consumers. The Government wants consumers to benefit from a broader range of enforcement powers that can be applied flexibly and the more pre-emptive approach to consumer protection to be taken by the CPMA. The regime should have the scope to make and amend rules without the need for primary legislation but with appropriate public consultation and cost-benefit analysis processes in place.
- **Simplification and deregulation:** The new consumer credit regime should promote opportunities for simplifying rules and regulation, removing any unnecessary burdens on firms that are not justified by the benefits to consumers.
- **Proportionality and cost effectiveness:** Finally, a new regime should be proportionate and fair, with resources within the regulatory regime allocated effectively.

**Box 1.C: Consultation question**

4. Do you consider these objectives for reform of the consumer credit regime to be appropriate and attainable?

# 2

## Options for the future regulation of consumer credit

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**2.1** As set out in Chapter 1, the Government wants to address a number of weaknesses in the current system of consumer credit regulation and create a more effective, proportionate and responsive regime. This chapter considers the options for the future regulation of consumer credit.

**2.2** The creation of the consumer protection and markets authority (CPMA – working title) provides an appropriate time to consult on this issue. Given ongoing work on the future of the competition and general consumer functions of the Office of Fair Trading (OFT) more widely, many of the OFT's current functions may in due course be transferred to other bodies. This consultation therefore focuses on the regulatory regime the Government would like to see for consumer credit.

**2.3** Two options are presented for consultation, predicated on a choice between a regulatory regime within a legal framework based on the model set out in the Financial Services and Markets Act (FSMA) and one based on the Consumer Credit Act (CCA). The options are:

- **Option 1 – Consumer credit is regulated under a new FSMA-style consumer credit rulebook by the CPMA.** In order to maximise the benefits of an integrated regime and to ensure consistency across the CPMA's remit, the CCA would be repealed and consumer credit regulation would be moved to sit within the same regime as other retail financial services. The Government recognises the significant challenge of designing a proportionate and effective regime under this option, and this is discussed in more detail in Chapter 3.
- **Option 2 – Consumer credit continues to be regulated under the CCA.** The CCA would remain in place and the regulation of consumer credit would remain separate to that of other retail financial services. The regulatory authority with responsibility for consumer credit under this option would not be confirmed until the outcome of the consultations on the future of the competition and general consumer functions of the OFT, which will be launched early in 2011.

**2.4** The Government recognises the difficulties that could arise as a result of uncertainty about the relevant regulatory authority under option 2. If, however, evidence from the responses to the consultation clearly favours retaining the CCA regime, the Government will take this into account and, if appropriate, hold a further consultation on the regulatory authority with responsibility for the CCA regime following the Government's broader work. This would consider factors such as:

- the fit between the CCA and the relevant regulatory authority's wider objectives and principles;
- legal or practical issues which might preclude the inclusion of the CCA within the remit of the relevant regulatory authority;
- synergies between the activities and products regulated by the CCA and the existing activities of the relevant regulatory authority; and

- the availability of relevant skills and resources within the relevant regulatory authority.

## Evaluating the proposals for reform

**2.5** The remainder of this chapter considers the proposals for reform against the four objectives presented in paragraph 1.18 of Chapter 1. **It concludes that the Government firmly believes that option 1, a move to a FSMA-style regime as part of the new CPMA, will deliver the best overall outcome for the regulation of consumer credit. It is therefore the Government's preferred option.**

### Objective 1: Delivering clarity, coherence and improved market oversight

**2.6** The Government believes that bringing together all retail financial services under one regulatory regime would bring a number of key benefits, including:

- removing the inconsistency in the regulatory treatment of retail financial services and eliminating a layer of complexity that can cause confusion. Currently, certain aspects of mortgages and current accounts with overdrafts are regulated under both FSMA and the CCA (for example, FSMA regulates the current account but the CCA regulates any authorised or unauthorised overdraft);
- delivering greater clarity and coherence for consumers and businesses, as they will be assured of a single point of contact for their regulatory queries or concerns. The improvements in the consumer protections this might afford are discussed under objective 2;
- simplifying compliance and removing unnecessary duplications, administrative complexity and burdens for firms currently subject to dual regulation under both the CCA and FSMA;
- improving market oversight. The Government's starting point, subject to further consultation, is that the CPMA would take on responsibility for all of the sectors covered by the current OFT consumer credit regime (including debt-related activities), although a proportionate approach would be taken, as outlined in Chapter 3. This would provide the CPMA with an overview of the entire retail financial services market. Increased market oversight should allow for earlier identification of trends and issues and appropriate escalation of these. This would be particularly valuable in identifying potentially significant credit risks. The inclusion of all retail financial services within its remit would mean that the CPMA would be better placed to draw a link between problems in one sector which may impact on other sectors (for example, recognising developments across both secured and unsecured lending markets), and to deal with these effectively; and
- strengthening the CPMA's role as part of the wider regulatory architecture. A key element of the reformed system of financial regulation will be the Financial Policy Committee (FPC) in the Bank of England. The FPC will have two objectives: improving the resilience of the financial system by identifying and addressing aggregate risks and vulnerabilities across the system; and enhancing macroeconomic stability by addressing imbalances through the financial system, for example by dampening the credit cycle. In pursuit of both of these objectives, the FPC's relationship and interaction with both the CPMA and the Prudential Regulation Authority will be crucial. The fact that the CPMA could have oversight over, and responsibility for, the entire regulated credit market would significantly strengthen its ability to support the FPC in its role, thereby contributing to financial stability more generally.

**2.7** Under a new regime – as under the current one – financial services will remain subject to the provisions of general consumer protection laws, such as the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) and the Consumer Protection from Unfair Trading Regulations 2008 (CPRs), as well as to specific European Directives such as the Payments Services Directive and the Consumer Credit Directive (CCD). Nonetheless, the Government believes that this complexity could be mitigated by having one regulator dealing with all of retail financial services which delivers a broadly unified approach to standard setting, authorisation, supervision and enforcement.

**Box 2.A: Consultation question**

5. The Government welcomes views on the impact a unified regulatory regime for retail financial services may have in terms of clarity, coherence and improved market oversight.

**2.8** There are of course a number of institutions aside from the OFT that have specific roles in the regulation of consumer credit (including Trading Standards Services, specialist Illegal Money Lending teams and the Department of Enterprise, Trade and Investment in Northern Ireland). The design of the future regime would need to consider how the benefits derived from the role of these institutions could be retained. FSMA currently allows for arrangements to be made for functions to be performed on behalf of the Financial Services Authority (FSA) by any body or person deemed competent in its opinion to perform them. Provided this remains the case for the CPMA, this might provide a useful model within which to consider a potential role for other institutions under a CPMA regime, subject to further cost benefit analysis and consultation.

**Box 2.B: Consultation question**

6. The Government welcomes views on the role of institutions other than the OFT in the current consumer credit regime, and the benefits they may confer.

## **Objective 2: Ensuring effective and appropriate consumer protection, including through a more responsive and flexible framework**

### **Building on existing levels of consumer protection**

**2.9** A key cornerstone of any transfer of responsibility for consumer credit would be to at least maintain – and where possible strengthen – overall levels of consumer protection, while recognising the role of consumer responsibility and that all risk will not be eliminated. The Government recognises that the current CCA regime provides for a number of important consumer protections that are valued by many stakeholders. These include, for example, the ability for consumers to challenge credit agreements in the courts on the grounds that the relationship as a whole is unfair to the debtor; discretion for the Court to decide whether to allow enforcement of an improperly executed agreement; and provisions for joint liability of creditors for certain breaches by suppliers of goods and services.

**2.10** The Government expects that the CPMA will build on the work already undertaken by the FSA as part of its new consumer protection strategy, and anticipates that in its role as a focused conduct regulator it will be even more proactive and effective in identifying and tackling the causes of consumer detriment.

**2.11** The Government does not expect there to be any overall dilution of current levels of consumer protection under option 1. However, it is unlikely that there would be a direct replication of the existing formulation of all CCA consumer protections in the rulebook. The regulator would need to conduct analysis of the consumer protections provided for under the CCA and would consider how best to ensure that a FSMA-style regime for consumer credit delivers at least equivalent levels of consumer protection (including whether this might require any changes to legislation). This would also include consideration of the important differences between the CCA and FSMA enforcement regimes. For example, under the current FSMA regime, breach of a rule does not make a transaction void or unenforceable or constitute a criminal offence (although it may give customers a right of court action for any loss suffered, and firms and individuals can be prosecuted for carrying out regulated activities without authorisation). However, the broader range of sanctions under FSMA may provide an equivalent level of consumer protection. It is also important to note that, to the extent that many consumer protections are enshrined in EU law through the CCD, there would in any case be limited scope for amending requirements relating to many types of credit agreements.

**Box 2.C: Consultation question**

7. The Government welcomes views on factors the Government or the CPMA may wish to consider in the event of a transfer of consumer credit regulation relating to how the overall level of consumer protection might best be retained or enhanced.

**2.12** A change in regime may also have an impact on the type of consumers covered by regulation. Under the CCA, all consumer lending is regulated, although some of the detailed requirements are modified or disapplied in certain circumstances. The CCA also regulates agreements for business purposes of up to £25,000 for sole traders, small partnerships and other unincorporated bodies, but does not cover larger loans which are wholly or predominantly for business purposes. Under FSMA, conduct of business rules will generally apply where the small business is borrowing as an individual – i.e. is a sole trader or an unincorporated partnership – and the loan is secured by a first charge on residential property (see Annex C for further detail on the application of the CCA, FSMA and self-regulatory codes to different consumers). In the event that a decision is made to transfer responsibility for consumer credit to the CPMA, the equivalent protections afforded by the FSMA-style regime could be extended to cover a broader range of borrowing by small firms for business purposes on a proportionate basis. The Government considers that this may be consistent with the CPMA’s role as a strong and focused conduct regulator.

### Box 2.D: Consultation question

8. The Government would welcome further evidence relating to:

- the use of consumer credit by small and medium sized enterprises (SMEs);
- whether the protections currently afforded by the CCA are appropriate and cover the right groups of businesses; and
- the costs and benefits of considering extending FSMA-style conduct of business rules to a wider group of SMEs.

## A more flexible and responsive framework

**2.13** A key benefit of a FSMA-style regime, which could afford greater consumer protection, is the fact that a rulebook regime is inherently more flexible and responsive than one set out in legislation. The core provisions of the CCA are enshrined in primary legislation, which is difficult to amend in the light of market developments and emerging practices. As a result, the framework may lag behind an evolving and dynamic market. In contrast, a FSMA-style rulebook<sup>24</sup> is 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.

**2.14** A more flexible regime should not however imply less scrutiny. There will be opportunities for industry and other stakeholders to provide input on the shape of the regime and the operation of the CPMA, both on an ongoing basis (for example through a statutory requirement to maintain consultative panels for consumers, small businesses and practitioners whose representations it must consider) and where specific regulatory initiatives are concerned. On the latter, the CPMA will be required in statute to conduct cost-benefit analysis and carry out full public consultation before making or amending rules or undertaking significant regulatory initiatives (except where this would prejudice the interests of consumers).

**2.15** In addition, while there will be no direct parliamentary scrutiny, the CPMA will be accountable to HM Treasury and Parliament in a number of ways. For instance, the CPMA will be required to produce an annual report that will be laid before Parliament by HM Treasury; and it will be subject to National Audit Office audit.

**2.16** The Government acknowledges that there may be concern that a shift to a more flexible FSMA-style rulebook could reduce certainty over the long term about rules that apply and the likelihood of change. However, as set out above, any such change and any transition period is subject to consultation and cost-benefit analysis and would not be undertaken unless a clear case for action has been made. Furthermore, primary legislation does not necessarily provide full long-term certainty and can also require guidance from regulators or ultimately the courts – for example, the proper application of the CCA provision dealing with multiple agreements (where more than one type of credit is involved) has been a source of controversy among legal commentators and has led to varying judgments in the courts.

<sup>24</sup> In the case of the FSA rulebook, this includes both principles (setting out broad outcomes without specifying in all cases the means for achieving those outcomes) and in some areas, more detailed rules to achieve specific consumer outcomes.

### Box 2.E: Consultation question

9. The Government welcomes views on how consumer credit firms and consumers may be affected by the increased flexibility that could be provided by a rules-based regime.

## Benefits from a FSMA-style supervisory approach

**2.17** The new CPMA will be a dedicated conduct regulator, focused on regulating the way in which financial services providers interact with their existing and potential retail customers, and whether they treat customers fairly. This focus on delivering the right consumer outcomes and protecting consumers where protection is needed would apply right across the spectrum of retail financial services, should consumer credit regulation move across to a FSMA-style regime under the CPMA.

**2.18** The FSA takes a graduated, risk-based approach to supervision and intervention, and this philosophy will also be essential to the CPMA operational model – namely that regulatory interventions should be proportionate to the risk they seek to address and that aiming for a zero-failure regime is neither realistic nor desirable<sup>25</sup>. The effect of proportionality in practice for consumer credit providers is set out in more detail in Chapter 3. However, the focus on regular reporting, firm governance, culture and systems and controls under a FSMA-style regime – complemented by thematic work across sectors or issues where appropriate – should deliver better outcomes for consumers. Furthermore, the CPMA will build on the FSA’s current approach to supervision and risk identification – it will be given new tools and powers and have a greater appetite to intervene, and to intervene earlier. This will require both a greater use of regulatory judgement to identify problems early, and a new, more conduct focused supervisory approach. More detail on both the legislative framework and approach to conduct supervision under the CPMA will be set out in further Government consultation during 2011.

### Box 2.F: Consultation question

10. The Government welcomes views on the impact a FSMA-style supervisory approach may have in terms of ensuring effective and appropriate consumer protection.

## Retaining existing synergies

**2.19** The Government recognises that a number of synergies afforded by the current regime can offer consumer protection benefits, and it would be important to consider how these benefits could best be retained in the design of a new regime. This would include consideration of both the OFT’s current links with other bodies (as outlined under objective 1), and the link between the OFT’s regulation of consumer credit and its application of general consumer protection rules. This is key given that consumers often regard the provision of credit and the provision of non-financial goods and services as a single transaction, even where there are separate contracts, and detriment often arises in respect of both.

**2.20** The fact that the OFT currently has responsibility for both consumer credit and general consumer protection rules means that there can be an exchange of relevant intelligence and

<sup>25</sup> “Consumers benefit from healthy, competitive markets where different firms try to meet their needs, compete actively and innovate – even if that means not all succeed. Although the idea that regulation should seek to eliminate all failures may look superficially appealing, the FSA can never eliminate risk entirely. In practice this would impose prohibitive costs on the industry and on consumers”, extract from *Consumer awareness of the FSA and financial regulation*, <http://www.fsa.gov.uk/pubs/consumer-research/cpr83.pdf>.



expertise to provide a coherent view of all aspects of a business. The CCA also contains provisions which reflect the links between credit agreements and contracts for the provision of goods and services, such as provision for the joint liability of the creditor and the supplier in certain circumstances. The Government recognises the need to ensure appropriate links between the CPMA and other bodies with a role in the wider consumer protection regime in order to ensure sensible outcomes for consumers. It has announced that the CPMA will continue to have concurrent consumer protection powers where another body is the lead enforcer of a general piece of consumer protection legislation that also applies to financial services (as is currently the case for the FSA in respect of the UTCCRs and CPRs).

**2.21** The current regime protects consumers from firms that engage in unfair or oppressive activities generally. This results both from OFT powers under the CCA – for example, the fitness test allows the OFT to consider all of a firm’s activities before and after granting a licence – and wider consumer protection legislation. The current FSMA regime also provides the flexibility to allow the FSA to consider a firm’s wider activities, for example, the FSA’s power to cancel or vary an authorisation can be used where this is desirable in order to protect the interests of consumers; and this flexibility will be carried over into the CPMA.

#### **Box 2.G: Consultation question**

11. The Government welcomes views on the synergies afforded by the current regime in tackling problems associated with the sale of goods and services on credit, and how these might best be retained in the design of a new regime.

### **Objective 3: Promoting opportunities for simplification and deregulation**

**2.22** The Government believes that a regulatory regime for consumer credit should be simple and transparent, protecting consumers from illegal or harmful business practice while ensuring burdens on firms remain appropriate. Opportunities for simplifying and deregulating the consumer credit regime (subject to the constraints of EU law) exist under both of the options proposed. The Government’s current review of consumer credit and personal insolvency, for example, considers where improvements could be made to the current consumer credit regime that might remove unnecessary burdens on firms without removing important consumer protections.

**2.23** The Government believes, however, that the opportunities for simplification and deregulation are clearer and more comprehensive under option 1, as the process of designing a new rulebook would involve a full review of existing consumer credit regulation. This is discussed in more detail in Chapter 3. While it would also be possible to make changes to the CCA under option 2, constraints on parliamentary time might mean these would be more incremental and piecemeal, and the requirement for amendments to primary legislation would introduce challenges of lengthy and uncertain timeframes.

### **Objective 4: Ensuring a proportionate and cost effective regime**

**2.24** Chapter 1 set out some of the differences between the current FSMA and CCA regimes. While a rulebook approach would confer a number of advantages, firms regulated under FSMA are subject to different requirements from those that exist under the CCA, and a transfer of consumer credit to the CPMA may therefore result in new obligations for firms in some areas.

**2.25** The precise content of a credit rulebook under option 1 would be subject to detailed consultation. There is no doubt that application of FSMA-style requirements to consumer credit firms could lead to important consumer protection and market oversight benefits. But the

Government recognises that it could also imply costs for firms, particularly those not already authorised by the FSA. The Government also recognises that concerns have been raised by some trade associations that specific characteristics of the unsecured credit market may justify a distinct regulatory approach. In the event of a transfer of consumer credit regulation, it would be essential to design a regime that ensures that costs to regulated firms are proportionate, fair and recognise the risks posed by particular elements of the consumer credit market. Chapter 3 explores how mechanisms and regulatory models provided for under a FSMA-style regime could help to achieve proportionate and effective regulation.

**2.26** It is also important to recognise that, while option 2 would mitigate the possibility of compliance costs associated with transition to a new regime, it could still entail changes and increased costs for firms. These could arise both as a result of possible wider institutional changes to the competition and consumer regimes, and reflecting any reforms resulting from ongoing work including the consumer credit and personal insolvency review.

## Summary: the Government's position

**2.27** This chapter has set out the reasons that the Government believes that option 1 would best deliver the four objectives outlined in Chapter 1 for a new regulatory regime for consumer credit. Table 2.A summarises the analysis of the options for consultation against these objectives.

**Table 2.A: Analysis of consultation options against objectives for reform**

Objective	Option 1 (FSMA-style regime)	Option 2 (CCA regime)
Clarity, coherence and improved market oversight	Consistent regulatory approach across all retail financial services. Improved market oversight possible via regular reporting, a single view across all consumer finance markets and a better resourced, more interventionist regulator. Could maintain benefits arising from current local/national sharing of roles.	No enhanced consistency and clarity as responsibility is divided between range of regulators and government departments, which apply different legal provisions. No improvements to market oversight, although benefits of local intelligence and monitoring are retained through the role of Trading Standards Services.
Effective and appropriate consumer protection, including through a more responsive and flexible framework.	Opportunity to strengthen overall existing consumer protections. Unintended consequences are relatively easy to correct and rules can be adapted as market evolves.	Existing consumer protections remain. Opportunities to strengthen the regime in future would depend on, for example, the availability of parliamentary time, particularly where a new Bill is required to effect any changes.
Simplification and deregulation	Provides a clear opportunity for simplification and deregulation.	Provides opportunities for simplification and deregulation but changes often subject to primary legislation to amend the CCA.
Proportionality and cost effectiveness	Risk of higher costs for directly regulated consumer credit firms, but mechanisms exist within a FSMA-style regime to ensure these are proportionate and fair, explored in Chapter 3.	No compliance costs associated with a transition to a new rulebook, but some increased costs could arise from reforms as a result of the consumer credit and personal insolvency review, and any wider institutional changes to the competition and consumer regimes.

**Box 2.H: Consultation questions**

12. Do you agree that transferring consumer credit regulation to a FSMA-style regime to sit alongside other retail financial services regulation under the CPMA would support the Government's objectives (as outlined in paragraph 1.18 of Chapter 1)?

13. Are there other advantages or disadvantages that you consider could result from transferring consumer credit regulation to sit alongside that of other retail financial services?

14. Are there specific issues that you believe the Government should consider in assessing the merits of option 1? How could these be addressed in the design of a new regime as proposed in option 1?

15. If you do not agree with the Government's preferred option 1, do you have views on the factors set out in paragraph 2.4 that the Government should consider in determining the most appropriate regulatory authority for the CCA regime under option 2?



# 3

## Achieving a proportionate and effective regulatory approach

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**3.1** Chapter 2 outlined the Government’s analysis of the merits of integrating consumer credit regulation into a consumer protection and markets authority (CPMA – working title) regime based broadly on the existing Financial Services and Markets Act (FSMA) framework. The Government recognises that this approach would represent a significant change in how consumer credit is regulated and the experience of firms and consumers who come into contact with the regime. As discussed in Chapter 2, the design of a new regime would need to consider important factors such as the consumer protections currently provided under the Consumer Credit Act (CCA); links between the consumer credit and wider enforcement functions of the Office of Fair Trading (OFT); and the role of Trading Standards Services.

**3.2** Chapter 1 highlighted that the population of firms currently regulated by the OFT is large compared to the Financial Services Authority (FSA) authorised population, and covers an extremely diverse range of sectors, associated with a broad and complex range of consumer issues. Many licensees are not financial services businesses themselves – less than 5% are actively lending money to consumers and the remainder may provide access to credit, allow payment in instalments for goods and services, or provide ancillary services. Furthermore, it is estimated that just over one third of OFT-licensed firms are sole traders. It would therefore also be essential to design a proportionate regime that reflects the need for varying degrees of regulatory focus and does not place unnecessary burdens on firms.

**3.3** The detail of a FSMA-style regime for consumer credit regulation would be for the CPMA to determine based on its own further analysis and consultation, though subject to the constraints imposed by EU law and the structure of the new CPMA regime. In doing so, the CPMA would draw on the experience and expertise of the OFT and Trading Standards Services. But the Government recognises that *how* consumer credit would be regulated by the CPMA is critical to a discussion of *whether* the CPMA should assume this responsibility.

**3.4** Without seeking to pre-empt the CPMA’s process of analysis and consultation, this chapter therefore provides an outline of, and invites respondents’ views on, key elements that a FSMA-style framework for consumer credit regulation might incorporate. The discussion explores how these might be applied proportionately to the range of businesses currently regulated by the OFT; regulatory models that might be appropriate as alternatives to direct CPMA authorisation in certain cases; and opportunities that a transfer might present for deregulation and simplification. These questions will inform consideration by the Government and the CPMA of how these factors could best be reflected in the design of a new regime.

### Core elements of a FSMA-style regime for consumer credit regulation

**3.5** While the CPMA would be responsible for the design of a consumer credit regime in the event of a transfer, there are some core elements of the current FSMA regime that the CPMA might consider applying (or in some cases be required to apply) to consumer credit firms to ensure that a new regime maximises consistency, clarity and opportunities for enhancing consumer protection.

**3.6** As highlighted in Chapter 1 and Annex B, important areas that are likely to represent a degree of divergence from current requirements under the CCA regime might include:

authorisation requirements; fee arrangements; Threshold Conditions; Approved Persons regime; systems and controls requirements; the Principles for Businesses; specific conduct of business and prudential rules; regular reporting; supervision and enforcement provisions.

**3.7** However, many of these FSMA-style requirements have some equivalents in the CCA regime; both regimes, for example, apply tests at the licensing/authorisation stages to determine whether firms are fit to operate in the relevant market and do not pose undue risks to consumers. It is also likely that a large number of consumer credit firms would already meet such requirements if the CPMA were to consider it appropriate to impose these following consultation. Responsible and professional firms would be expected, for example, to hold adequate capital for the operation of their business, and firms already subject to the CCA regime should be treating their customers fairly and have competent and appropriate staff in key positions.

**3.8** Some of the provisions would, however, result in more routine formal contact with the regulator for many firms not already authorised by the FSA or would represent a new formal obligation (for instance, the potential for a specified minimum capital requirement<sup>26</sup>). These would need to be considered in the context of the costs and benefits they may confer and taking into account the nature of the products and services in question. For example, adequate resources requirements would, among other things, provide funds to enable a more orderly wind down of a firm and ensure that it had in place effective means by which to manage risks, thereby helping to protect its customers and other businesses. Regulatory reporting requirements can also be an important tool for effective supervision, helping to identify areas of concern early, reducing the potential for detriment to consumers, and enhancing availability of information on market activity.

**3.9** In designing a new regime as proposed in option 1, it would be necessary to consider the extent to which such requirements are appropriate for the whole of the population currently regulated by the OFT. As outlined in Chapter 1, this population covers a diverse range of firms undertaking activities including consumer credit business, consumer hire business, credit brokerage, debt adjusting, debt counselling, debt collecting, debt administration, credit information services and credit reference services. The FSMA framework incorporates a number of important mechanisms for ensuring that a risk-based, proportionate approach can be taken to the application of these regulatory tools, and these are outlined in the next section.

#### **Box 3.A: Consultation question**

16. The Government welcomes views on the suitability of the provisions of a FSMA-style regime, such as those referred to in paragraph 3.6, to different categories of consumer credit business.

## **Ensuring a proportionate approach under a FSMA-style regime**

**3.10** The Government recognises the importance of ensuring that compliance burdens for lenders and intermediaries remain proportionate and appropriate to the risks posed by the consumer credit sector, and that any increases in costs reflect real and justifiable benefits for consumers and the market. Mitigating the effect of increased compliance costs – particularly

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<sup>26</sup> While recognising that funds move away from the supplier in the case of consumer credit lending, the FSA currently requires regulated firms to hold an adequate level of capital in order to ensure a well-run regulated business and to meet future liabilities. Minimum capital requirements are a component of the FSA's Threshold Condition relating to adequate resources in relation to the specified regulatory activities a firm carries on or seeks to carry on. Resources include all financial resources, non-financial resources and means of managing its resources (including capital, provisions against liabilities, human resources, holdings of or access to cash and other liquid assets, and effective means by which to manage risks, including credit risk).

where these could have a disproportionate impact on small firms – would be essential in minimising the risk of market exit and the resultant possibility of reduced competition; restricted supply of regulated credit; and increased unauthorised trading.

**3.11** A number of provisions of the current FSMA regime might help to ensure a proportionate approach to consumer credit regulation, considering the type and depth of regulation necessary for different categories of activity. In the context of the separate consultation process relating to the broader arrangements for the CPMA, the Government welcomes views on how the following mechanisms might contribute to a proportionate and effective CPMA regime for consumer credit regulation.

### **a) Statutory processes**

**3.12** *A new approach to financial regulation: judgement, focus and stability* highlights the statutory processes to which the CPMA's rule-making function will be subject. These include a duty (except where it would prejudice the interests of consumers) to carry out and consult on detailed cost-benefit analysis prior to the introduction of any new rules; consultation with statutory panels representing the interests of consumers and practitioners; and wider public consultation<sup>27</sup>.

**3.13** These processes will provide an important means of ensuring that new rules are effective and proportionate through requiring the CPMA to explain why regulatory interventions are needed; consider the relative merits of different policy options (including consideration of equality and diversity); and take into account representations on the possible impacts on consumers and industry.

**3.14** HM Treasury is also considering whether the principles of good regulation as currently outlined in FSMA – including, for example, the principle that a burden that is imposed on a person should be proportionate to the benefits that are expected to result from the imposition of the burden – should be applied to the CPMA. The Government is committed to enshrining proportionality in the principles of good regulation, which would provide a further mechanism for ensuring that regulation by the CPMA is proportionate and effective.

### **b) Risk-based approach to regulation**

**3.15** The FSA's current risk-based approach to regulation allocates regulatory resources according to the risk a firm poses to the FSA's statutory objectives, with risk assessed on the basis of impact (scale and severity of the effect on consumers and the market if risk was to crystallise) and probability (likelihood of risk crystallising). This determines the nature and intensity of the regulatory relationship between the firm and the FSA.

**3.16** Medium and high-risk firms are allocated a relationship manager who carries out a risk assessment and determines a risk mitigation programme. High-risk firms are supervised on a 'close and continuous' basis and the small number of very high impact firms are subject to the most intensive and intrusive supervision. As smaller firms can pose a collective risk to the FSA's objectives, the risk-based supervisory approach has been adapted for these firms – information is collected from a variety of sources (e.g. regulatory returns, complaints data and thematic assessments); data analysed to identify collective risks; further investigation conducted where necessary; and research results communicated or enforcement action taken against individual firms.

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<sup>27</sup> The CPMA's functions will also be subject to statutory processes governing its interaction with the Prudential Regulation Authority and the Financial Policy Committee.

**3.17** The Government expects that the CPMA will also apply outcomes-focused regulatory requirements proportionately following consultation and cost-benefit analysis. For firms that are already relationship-managed (for example, many large credit institutions and credit card issuers), consumer credit supervision could be rolled into their existing supervisory arrangements. For a small number of firms, this may change their impact categorisation. A horizontal thematic supervision programme could be considered for higher-risk activities undertaken by small firms. Small firms undertaking lower-risk activities could be monitored via their regulatory returns and complaints-led intelligence.

**3.18** In terms of enforcement, the FSA takes a risk-based approach in selecting which cases to pursue. This includes considering the statutory objectives, the principles of good regulation and a set of referral criteria. The FSA considers carefully what course of action would be a proportionate response, exercises a common standard of fairness in the use of its powers, and acts in a manner consistent with the Human Rights Act 1998<sup>28</sup>.

**3.19** An example of the flexibility provided by the FSMA regime to tailor the regulatory approach to the specific characteristics of particular activities is provided by the FSA regulation of credit unions, described in Box 3.B. In the event of a transfer of consumer credit responsibility, the CPMA would in a similar way consider the costs and benefits of additional requirements; ensure proportionate application of regulatory tools; and adapt current risk metrics to accommodate the diverse range of credit activities and the specific risks which may affect consumers of credit and debt services.

#### **Box 3.B: FSA regulation of credit unions under FSMA**

The FSA takes a proportionate approach to the regulation of nearly 500 credit unions, and has developed rules under the FSMA regime that are appropriate to their special character and the nature of credit union business. The rules are also tailored to the relatively low risk that credit union failure would pose to economic stability.

Credit unions are subject to many of the FSA rules that apply to other regulated deposit-takers (such as the Principles for Businesses and rules on Approved Persons and systems and controls). However, many of these rules are applied proportionately to the nature, scale and complexity of a credit union's activities.

The FSA has developed specialised prudential rules, set out in the Credit Unions sourcebook, which relate to such issues as capital and liquidity requirements; provisioning for bad and doubtful debts; and large exposures. These rules aim to ensure that credit unions are financially sound, but they are simpler than, and not as onerous as, the rules that apply to larger, more complex and riskier deposit-takers.

### **c) Differentiated fee-raising arrangements**

**3.20** The CPMA will be funded entirely by firms providing regulated financial services. It will be responsible for setting the fees in respect of the activities under its remit, following consultation, and as such would assume responsibility for setting fee structures for consumer credit firms in the event of a transfer. The CPMA's funding arrangements are being considered as part of HM Treasury's wider regulatory reform proposals. Nevertheless, potential fee-raising arrangements for consumer credit firms would be developed in accordance with the key overriding principles

<sup>28</sup> More information is available in the FSA's Decision Procedure and Penalties manual (<http://fsahandbook.info/FSA/html/handbook/DEPP>) and Enforcement Guide ([http://www.fsa.gov.uk/pages/doing/regulated/law/pdf/enf\\_procedure.pdf](http://www.fsa.gov.uk/pages/doing/regulated/law/pdf/enf_procedure.pdf)).



that the Government has stated would underpin a transfer – including fairness, transparency, proportionality and continuing to ensure that costs incurred in delivering the consumer credit regime are recovered through fees. A CPMA funding regime should also ensure simplicity for firms while avoiding cross-subsidy. In order to achieve these aims, fee levels would need to reflect any increased costs associated with achieving improvements in the regulatory regime.

**3.21** Any changes in fee arrangements in the event of a transfer of consumer credit should be considered in the light of potential shortcomings in the current licensing fees regime. In December 2009, the OFT issued a consultation on revising its consumer credit licensing fees<sup>29</sup> in response to concerns around the current charging structure's ability to reflect the differential costs of regulating different types of activity and the risk-based regulatory approach. This noted that the current licensing regime does not allocate fees fairly between different types of licensed firms (for example, a large multinational pays the same fee as a small limited company).

**3.22** Nevertheless, the Government recognises that there is a significant discrepancy between the typical fees paid under the current FSA and OFT regimes, and the period over which they apply, and that a transfer would be likely to result in increased fees for many firms. In particular, any regulatory costs resulting from a more intrusive CPMA regulatory approach that allocated increased resource when compared with the current arrangements would need to be recovered through fees. Whereas the OFT currently charges a licence application fee of £330 for sole traders and £820 for others, with a maintenance payment payable every five years thereafter<sup>30</sup>, the FSA charges a one-off application fee and an annual periodic fee, both of which currently have minimum levels higher than OFT licence fees.

**3.23** In setting fee levels for authorised credit activities, the CPMA would take a proportionate approach and consider the appropriate level for minimum fee requirements for different categories of firm. In doing so, the CPMA may take into account the OFT's work relating to the burden associated with regulating different consumer credit businesses<sup>31</sup>.

**3.24** Currently, FSA fee-raising arrangements provide the flexibility to ensure that fees are proportionate and reflect variations in the resources employed by the regulator for different firms. The illustrative figures below reflect current business-as-usual costs, which take no account of potential economies of scale resulting from a large migration of firms.

**3.25** Application fees vary according to category of business and application complexity. There are three main types of application fees:

- straightforward: £1,500 (for example, sole trader independent financial advisers and those firms applying for arranging activities);
- moderately complex: £5,000 (for example, investment managers where they are applying for safeguarding permissions and administrators/custodians); and
- complex: £25,000 (for example, deposit-takers/banks).

Where firms are already regulated by the FSA for other activities, application fees for a variation of permission currently range from £750 to £12,500, depending on activity.

**3.26** For calculation of periodic fees, firms are grouped into fee blocks according to their regulated activity, to mitigate cross-subsidy between those activities. As fees for publicly-

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<sup>29</sup> *Review of consumer credit licensing fees: a consultation*, Office of Fair Trading, December 2009, <http://www.cdfa.org.uk/wp-content/uploads/2010/02/review-of-consumer-credit-licences-fees.pdf>.

<sup>30</sup> Maintenance fees will come into effect from 2013, when the current cycle of applications for indefinite licences is complete, and are likely to be similar in magnitude to the licence application fee.

<sup>31</sup> Key factors identified in the OFT's consultation document include credit activity, type of business, number of trading names applied for, number of categories applied for, format of submission, priority of application, authorisation, size of credit business and overall size of business.

provided goods and services must cover costs, annual fees change in line with the overall annual funding requirement. The FSA allocates firm supervisory costs, taking into account the risk profile of firms. Non-supervisory costs are allocated as far as possible to fee blocks whose regulated activities the costs concern (e.g. policy development work). The FSA have recently introduced a minimum annual fee of £1,000 from 2010/11, which includes the cost of the firm contact centre, regulatory reporting and policing the perimeter to ensure that only authorised firms are carrying on regulated activities.

**3.27** Exceptions to the general approach are permitted where these can be justified. This is currently the case for smaller credit unions and non-directive friendly societies, which offer support to those with limited financial resources – for example, much lower authorisation fees of between £200 and £1,800 are charged to credit unions. This is only possible, however, where other regulated firms subsidise these exemptions and following consultation on this basis.

**3.28** The Government has announced that, in addition to setting the levy for its own activities, the CPMA will also be responsible for making rules in respect of industry funding of the Financial Ombudsman Service (FOS), Financial Services Compensation Scheme (FSCS) and Consumer Financial Education Body (CFEB). The OFT regime already imposes FOS levies on consumer credit firms and the OFT will have powers from April 2011 to levy consumer credit licensees or applicants to meet a proportion of CFEB's costs. Under option 1, the CPMA would be the one body collecting these fees. Further consideration and consultation may be required on the appropriateness of applying FSCS coverage (and the associated levy) to consumer credit businesses.

#### **Box 3.C: Consultation questions**

17. Do you agree that statutory processes relating to CPMA rule-making, a risk-based approach to regulation and differentiated fee-raising arrangements could provide useful mechanisms in ensuring that a proportionate approach is taken to consumer credit regulation under a FSMA-style regime?

18. The Government welcomes views on key factors that would need to be assessed in considering fee arrangements for consumer credit firms.

## **Alternative regulatory models to direct CPMA-authorisation**

**3.29** A transfer of consumer credit responsibility to a FSMA-style regime could also provide an opportunity to explore how models provided for under FSMA that have proved successful in other regulatory contexts may be applied to consumer credit firms. These could play a useful role in protecting firms from disproportionate costs and benefit both firms and consumers.

### **a) Appointed representatives regime**

**3.30** The appointed representatives (AR) regime provided for under FSMA currently allows an authorised firm (the principal) to appoint representatives to conduct certain activities on its behalf. The principal takes responsibility for the actions of their appointed representatives in carrying out those activities; for ensuring that its appointed representatives are fit and proper to deal with clients on its behalf; and that they comply with all the relevant FSMA requirements such that any customer dealing with its appointed representatives has the same level of

protection as if they had dealt directly with the principal<sup>32</sup>. Depending on the type of business and customers, an AR may have more than one principal. The CCA does not draw distinctions of this kind – all relevant businesses must be covered by a licence.

**3.31** Examples of credit activities for which an approach based on the AR model could potentially be considered might include credit brokerage activity designed to support the sale of goods. In this case, it may be possible that creditors (who would need to be authorised) could appoint certain brokers as appointed representatives – who would then be exempt from authorisation and for whose compliance the creditor would be responsible – reducing compliance burdens for retail credit brokers compared to full authorisation. Experience of the current regime suggests that finance companies often already lead on or support the legislative compliance of, for example, franchised motor dealers or other retailers undertaking credit brokerage activities and as such that this approach might be applicable to these sorts of firms, subject to further analysis of feasibility and potential risks to consumers. It is estimated that a significant proportion of the nearly 30,000 FSA appointed representatives currently active as retail intermediaries are also licensed by the OFT for credit brokerage activities (for example, independent financial advisers; motor dealers; and other retailers brokering both credit and insurance).

**3.32** It would be important to ensure that the design and scope of an AR model retained sufficient leverage over firms to avoid consumer protections being compromised (in line with the current obligation for principals to be authorised firms and to have adequate controls and resources to ensure that their appointed representatives are fully compliant with relevant regulatory requirements). In particular, careful consideration will need to be given to the risks associated with an AR regime for activities which are considered high risk under the current OFT risk model. While powers to take action under general consumer law would be retained in relation to appointed representatives, such powers are less precise than those available under the CCA in addressing particular issues – for example, the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) apply to failures to act with professional diligence but do not directly tackle credit competence matters.

**3.33** Any AR model would also have to satisfy the requirements for regulation of credit intermediaries contained in the Consumer Credit Directive (CCD) and it would be essential to assess carefully burdens on business that might arise where a lender uses a large number of brokers and possible effects on competition and availability of credit if lenders consequently restrict their brokering networks.

#### **Box 3.D: Consultation questions**

19. The Government welcomes:

- evidence relating to experiences of the current appointed representatives regime;
- views on how an appointed representatives model might be applied to different categories of consumer credit activities, including how current business models and networks might lend themselves to such an approach; and
- evidence relating to the implications an appointed representatives regime might have for firms and consumers.

<sup>32</sup> In relation to access to the FOS, a complaint arising from an appointed representative's act or omission is dealt with by the principal's complaints department; if the complainant remains dissatisfied, it turns into a FOS case against the regulated firm.

## b) Provisions akin to current group licensing regime

**3.34** The current consumer credit licensing regime allows professional and other bodies to apply for group licences to cover members of the group for specific credit activities. Group licences may be granted where the OFT is persuaded that the public interest is better served by granting the group licence than by requiring those concerned to apply for individual licences. The two broad categories of applicant that generally meet group licensing criteria are professional bodies, with established disciplinary arrangements, where credit activity is not usually the primary business of their members (for example, a number of UK law societies); and advisory, non-profit organisations with altruistic aims (such as Citizens Advice).

**3.35** There is currently no group licensing regime under FSMA. However, separate provision is made in FSMA for members of professional bodies who carry on regulated activities in the course of their profession. Under these provisions, members of the professions may carry on certain regulated activities under the supervision of their professional body without being regulated by the FSA. HM Treasury has responsibility for designating professional bodies, on which it seeks the views of the FSA. The FSA is then responsible for approving the rules of these bodies and remaining informed about the way they monitor exempt professional firms and their activities.

**3.36** The CPMA would need to undertake further analysis of the costs and benefits of this approach – and consult accordingly – to establish whether adapting the current regime to enable greater use of such models may provide a useful mechanism in contributing to a proportionate regulatory approach, with a particular focus on lower-risk categories of firm.

### Box 3.E: Consultation questions

20. The Government welcomes:

- evidence relating to experiences of the current group licensing regime; and
- views on how the professional bodies regime might be adapted for different categories of consumer credit activities.

## c) Voluntary codes

**3.37** Self-regulation, such as voluntary industry codes of practice, can play a valuable role in responding to problems in the market quickly, delivering better outcomes for consumers while keeping the formal regulatory burden to a minimum. The CPMA would need to consider and consult on whether a reformed consumer credit regime could formally incorporate provisions set out in existing voluntary codes or whether such provisions should remain the subject of self-regulation, perhaps with provision for CPMA confirmation of industry guidance.

### Box 3.F: Consultation question

21. The Government welcomes views on the extent to which self-regulatory codes might continue to deal with aspects of lending to consumers and small and medium enterprises (SMEs).

## Opportunities for simplification and deregulation

**3.38** The creation of a new rulebook for consumer credit regulation could provide an opportunity to explore how the regime could be made simpler and more transparent, and in particular to consider specific opportunities for deregulation of certain categories of activity.

**3.39** As part of its consultation on its rules, the CPMA would consider whether the regime could be simplified through removing provisions that may result in undue burdens or complexity. This should also be considered in the context of the Government's call for evidence in support of the consumer credit and personal insolvency review, which invited views on issues raised by stakeholders including deregulatory proposals. The flexibility of a rulebook regime would also enable more rapid resolution of any unintended consequences that may arise in the future, or to respond to market developments.

**3.40** Scope for deregulation is constrained by a number of important factors, foremost among which is risk to consumers given the link between certain types of credit provision and significant, infrequently repeated consumer transactions. As such, consideration of exempting certain categories of activity from regulation would only be appropriate where the risk of consumer detriment is low and can be tackled effectively via other means. Further legislative constraints also exist as a result of the requirements of EU law (in particular the CCD), as well as practical challenges of drawing workable legal distinctions in some areas (for example between different forms of 'credit').

**3.41** Nonetheless, the creation of a new FSMA-style regime provides the opportunity to remove some of the constraints to which the current regime is subject and to consider where the CCA regime may currently place unnecessary burdens on firms which are not justified by the risks to consumers, or where it could be rationalised within a CPMA regime to minimise burdens and better align with CPMA objectives.

**3.42** Further analysis is needed to determine – in the light of the constraints mentioned above – the extent to which deregulation would be feasible or desirable, but areas in which scope for this might be considered include:

- low risk categories of business where other legislation may address consumer detriment. Careful consideration would of course have to be given to how potential associated risks may be mitigated (e.g. that firms may redesign their business models in order to evade regulation);
- categories where effective parallel regulation or control via professional standards exists (e.g. consideration might be given to whether Charities Commission rules provide adequate safeguards for the clients of free debt advice provided by charitable organisations); and
- tightening up definitions of licensable activity so that certain firms are excluded (e.g. while only a few credit reference agencies provide reports on consumers' creditworthiness to support underwriting decisions by lenders, the current definition creates uncertainty as to whether a much larger group of businesses are caught. There may be a question as to whether the latter group should be regulated, or whether they would be better regulated within a different category of businesses, appropriately reflecting the risks they pose to consumers).

**Box 3.G: Consultation question**

22. Do you consider that there would be a case for deregulation of certain categories of consumer credit activity in the event of a transfer? Please explain why.

**Box 3.H: Consultation question**

23. Are there other ways in which the design of a new consumer credit regime based on a FSMA-style framework might ensure a proportionate and effective approach?

# 4

## Implementation and transitional arrangements

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**4.1** If a decision is made to adopt a Financial Services and Markets Act (FSMA) style regime for consumer credit and transfer responsibility to the new consumer protection and markets authority (CPMA – working title), the necessary reforms would take several years to implement and entail implementation costs for both the regulator and industry.

**4.2** The Government recognises the significant challenge that would be entailed in undertaking a reform of this magnitude. The currently licensed population incorporates 96,000 lenders, intermediaries and ancillary credit providers, a majority of which are not authorised by the Financial Services Authority (FSA). A transfer would therefore represent a significant increase in the number and range of firms for which the CPMA has responsibility. Furthermore, any transfer would need to be considered in the context of other changes to which the consumer credit industry has been subject in recent years (for example, those introduced by the Consumer Credit Act (CCA) 2006 and implementation of the Consumer Credit Directive). As a result, the Government is committed to extensive engagement and consultation on this issue and has announced that any work on transferring consumer credit may progress on a longer timetable to wider regulatory reform.

**4.3** Transitional arrangements will have an important bearing on both timescales and costs, and key issues relating to the transition may therefore in part inform stakeholders' views on a transfer. Without prejudging the outcome of the consultation, the Government therefore considers that it is important to provide some clarity on how a possible transition could be effected.

### Timing

**4.4** It is anticipated that the full implementation process would be likely to take in the region of three years from a decision to proceed, and would not be completed before mid-2014. If the decision is taken to transfer consumer credit responsibility, the Government would include legislative clauses to provide for this in its forthcoming Bill to deliver wider reform of the UK's financial regulatory architecture. The Government intends to bring forward this Bill in mid-2011 and expects that Royal Assent will be achieved within a year of introduction. The scope of CPMA regulation will be set out in secondary legislation<sup>33</sup>. The regulator would then prepare and consult on a new rulebook and would make the necessary operational arrangements to establish the new regime. This would also allow the industry to adjust to the changes, for instance in relation to changes to their IT systems and training of personnel.

**4.5** The implementation process would begin in advance of the establishment of the CPMA, which will occur in 2012. It is expected that the FSA and Office of Fair Trading (OFT) would conduct a joint study of consumer credit markets, and the FSA would then consult on proposals for implementation of the new regime by the CPMA. This would initially cover key areas such as authorisation; prudential requirements; and its high-level approach to consumer protection rules. A further consultation would subsequently be conducted on the detail of the rules. After

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<sup>33</sup> Currently, the scope of FSA regulation is established through FSMA. The Financial Services and Markets Act 2000 (Regulated Activities) Order (RAO) sets out a list of activities regulated under FSMA, and the FSA is the body responsible for regulating these activities.

publication of final rules by the CPMA, an appropriate transitional period would be needed in order that firms can prepare for implementation. The length of this transitional period would itself be subject to consultation, but would be likely to be in the region of 12 months.

## Transitional arrangements

**4.6** The Government would work with the regulators to ensure that business continues as usual while changes are implemented, and believes that this work should be guided by principles including the following:

- maintaining high quality, well resourced, focused regulation;
- minimising transitional costs, disruption, complexity and uncertainty for firms, consumers and those delivering the regime;
- balancing swift implementation with appropriate scrutiny and consultation, allowing the industry and the regulators sufficient time to adjust to any regime change, consider resource implications and to give full consideration to the framing and implementation of new rules; and
- providing as much clarity and certainty as possible for FSA, OFT and other staff affected by the proposals.

## Key issues to consider

**4.7** In the event of a transfer of consumer credit responsibility, the Government would need to consider what transitional provisions would be necessary in relation to issues such as prosecutions and legal actions in train at the date of a transfer. In addition, the FSA would include in its consultation consideration of suitable arrangements for the transitional period for issues within the scope of its rules. The Government recognises that there are certain key issues relating to transitional arrangements on which stakeholders would welcome early clarity.

**4.8** The detail in the case of issues within the scope of CPMA rules would ultimately be a matter for the CPMA to determine under its rule-making power. It would therefore not be appropriate for the Government to set out at this stage how such matters would be resolved. Recognising this and that there are a range of other transitional issues that would need to be addressed in detail in due course, this section identifies certain key issues that may be involved in any transfer to a new regime and the principles according to which the Government would expect these to be addressed.

## Treatment of agreements already in existence

**4.9** In the event of a transfer of responsibility for consumer credit to the CPMA, a key consideration would be how a new CPMA regime might apply to agreements already in existence and regulated under the CCA, or 'back books'.

**4.10** The Government believes that retaining an entirely separate CCA regime for agreements entered into before the date of a transfer would entail significant risks. This approach could undermine the Government's objectives for creating a consistent regulatory regime for all retail financial services; introducing additional complexity; and limiting the number of firms and consumers able to benefit from the advantages afforded by a new regime. Furthermore, it is unlikely to be efficient to run a residual CCA regime solely for regulating agreements entered into before the transfer.

**4.11** As a result, the Government proposes that agreements already in existence should be included in any transfer of consumer credit regulation to the CPMA. The CPMA would consult



on and make rules relating to the treatment of agreements already in existence and would consult on the time firms would need to adjust to new rules.

**4.12** The Government recognises, however, that transferring existing agreements to the CPMA could increase transitional costs for firms and give rise to distinct challenges. It would be essential to maximise consistency and clarity for firms and consumers in the treatment of existing agreements.

**4.13** As a general principle, the Government would expect consumer credit firms to comply with CPMA requirements in respect of their existing agreements – and that CPMA rights and protections would therefore apply to all existing agreements – from the date of a transfer. This would mean that firms could run common systems for all accounts and consumers would have consistent rights regardless of when they entered into the agreement. Depending on the nature of the rights concerned and the duration of agreements, there may be certain CPMA rules (that confer rights on consumers) where consideration would be needed as to whether these should apply to all agreements in existence or only to those entered into after the new regime has come into effect.

**4.14** However, if the CCA gives significant additional rights and protections, consideration would need to be given to maintaining them unless a CPMA rule can be put in place for existing agreements that offers at least as much overall protection for the consumer. In addition, transitional arrangements would be needed to address processes underway at the date of repeal of the CCA, including, for instance, prosecutions, other legal actions and periods of right of withdrawal.

#### **Box 4.A: Consultation question**

24. The Government welcomes views on how the treatment of agreements already in existence could be approached.

## **Approach to existing licensees**

**4.15** If a decision is taken to transfer consumer credit responsibility to the CPMA, the Government and the CPMA would also need to consider the treatment of existing OFT issued licences, and whether it would be appropriate to consider “grandfathering” some licensees into the CPMA regime.

**4.16** As outlined in Chapter 3, a FSMA-style regime for consumer credit regulation under the CPMA would be likely to impose different requirements on regulated firms as compared to the current CCA regime in a number of areas. In light of these differences – and to maximise consumer protection and ensure consistency of standards – the Government is not in a position to give assurance that firms that currently hold a consumer credit licence would automatically be allowed to continue to operate in the areas covered by the licence. This is particularly pertinent given that consumer credit licences issued by the OFT after April 2008 were granted for an indefinite period.

**4.17** As a result, existing licensees may need to apply for CPMA authorisation or to vary any existing CPMA permission they might hold<sup>34</sup>. However, the Government recognises that this would result in additional costs for firms and an important element of the design of any new

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<sup>34</sup> Existing consumer credit licensees that were already authorised by the CPMA for other activities would be able to apply to vary their permission. The current process for this includes the provision of additional information about the firm relating to the new regulated activities (such as consumer credit lending or intermediating) which they would be carrying on.

regime would be consideration of whether a modified approach could be adopted. Careful consideration would be needed as to whether it was appropriate to allow some firms to continue to operate in the areas covered by their existing licence. Relevant factors may include, for example, whether the segment is low risk, the level of scrutiny given to their consumer credit licence application and whether they could receive any 'due credit' based on their compliance history. In the case of the regulation of credit unions by the FSA, for example, HM Treasury's order setting out transitional provisions<sup>35</sup> provided that all unauthorised credit unions were to be treated as having permission to accept deposits, but enabled the FSA to require credit unions of a specified description to reapply for permission.

#### **Box 4.B: Consultation questions**

25. The Government welcomes views on:

- how existing licensees could be dealt with; and
- factors that should be considered in determining whether a modified approach could be adopted for particular categories of licensed firms.

## **Fees**

**4.18** Another key area for consideration by the Government and the regulators if a decision is taken to transfer consumer credit responsibility would be the appropriate arrangements for transitioning from the current to the future fee structure. As highlighted in Chapter 3, there are important differences between the level and frequency of fees required under the current CCA and FSMA regimes and it would therefore be essential to manage the impact of any changes.

**4.19** In previous regulatory transfers (for example of travel insurance and credit unions), the FSA has managed transitional arrangements by providing discounted authorisation fees during the transitional period. In the event of a transfer, the FSA would need to consider whether this could provide an appropriate means of managing fee arrangements during transition and consult accordingly.

**4.20** The Government also recognises that it would need to consider how best to reflect the contribution of firms whose most recent five year maintenance period has not expired.

#### **Box 4.C: Consultation question**

26. The Government welcomes views on key factors that would need to be considered in transitioning from the current to a new fee structure.

## **Institutional transition**

**4.21** The simplest institutional arrangements for a possible transition from a CCA to a FSMA-style regime would be for institutional responsibility to be transferred at the same time as the new legal framework is commenced. On the assumption of a three year transition as described above, this would be in mid-2014.

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<sup>35</sup> <http://www.legislation.gov.uk/uksi/2002/704/made>.

**4.22** As highlighted above, the Government will be consulting on wider institutional changes to the competition and consumer regimes in 2011. More detail on the timetable for this work and its potential impact on the OFT will be set out following this consultation, but the Government does not currently envisage that there will be any significant changes in oversight of the consumer credit regime during the transitional period.

**4.23** Regardless of any wider changes, the Government would ensure that suitable arrangements are made to ensure continuity of effective consumer credit regulation through the transitional period, taking account of the principles outlined above as well as institutional reforms to the competition and consumer regime and the wider financial services regulatory framework.

**Box 4.D: Consultation questions**

27. Are there other factors the Government should take account of in considering transitional arrangements?

28. The Government would welcome evidence on the experience of firms, consumers and their representatives in relation to similar previous transitions, for example the extension of FSA jurisdiction to new markets since 2000.



# 5

## How to respond, next steps and devolved issues

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### How to respond to this consultation

**5.1** This consultation asks a range of questions to establish the merits and risks of transferring responsibility for consumer credit regulation from a Consumer Credit Act (CCA) to a Financial Services and Markets Act (FSMA) style regime. The Government is seeking to understand how stakeholders would be affected by a transfer and the potential impacts.

**5.2** The Government has liaised closely with the Financial Services Authority (FSA) and Office of Fair Trading (OFT) in developing this consultation and has gathered further evidence by meeting with and receiving submissions from interested consumer and industry groups. The evidence supporting the proposals is set out in the Impact Assessment that accompanies this consultation. The responses to this consultation will help inform the Government's decision on the appropriate course of action.

**5.3** For ease, we have referred simply to "consumers" throughout this consultation. However, we would welcome responses from small businesses and their representatives, sole traders and partnerships, who may be users of consumer credit for business purposes.

**5.4** This consultation paper is available electronically at [www.bis.gov.uk/Consultations](http://www.bis.gov.uk/Consultations) and [www.hm-treasury.gov.uk/consult\\_consumer\\_credit.htm](http://www.hm-treasury.gov.uk/consult_consumer_credit.htm) along with the accompanying Impact Assessment. You may make copies of this document without seeking permission. Printed copies of the consultation document can be ordered on request from the address below. A Welsh language version of the foreword and executive summary is available on request and where possible we will also make other versions of this document available on request in other formats.

**5.5** Responses are requested by 22 March 2011. The Government will also engage directly with relevant stakeholders ahead of this date. Please ensure that responses are sent in before the closing date. The Government cannot guarantee that responses received after this date will be considered.

**5.6** Responses can be sent by email to: [financial.reform@hmtreasury.gsi.gov.uk](mailto:financial.reform@hmtreasury.gsi.gov.uk). Alternatively, they can be posted to:

Financial Regulation Strategy  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

**5.7** When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make clear who the organisation represents and, where applicable, how the views of members were assembled.

**5.8** If you have concerns about the way in which this consultation is being managed or conducted, please refer to Annex F, which details the Code of Practice for written consultation and provides contact details for complaints.

## Confidentiality and data protection

**5.9** Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004).

**5.10** If you want information, including personal data, that you provide to be treated as confidential, do mark this clearly in your response. However, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances.

**5.11** In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded unless an explicit request for confidentiality is made in the body of the response.

## Next steps

**5.12** The Government will aim to produce a response to this consultation in the spring. If the Government decides to proceed with its preferred option, legislative clauses would be included in its forthcoming Bill to deliver wider reform of the UK's financial regulatory architecture. As set out in the Queen's speech and detailed in *A new approach to financial regulation: judgement, focus and stability*, the Government intends to bring forward this Bill in mid-2011 and expects that Royal Assent will be achieved within a year of introduction. But the Government recognises the complexity of designing a proportionate and effective new regime for consumer credit and therefore acknowledged in *A new approach to financial regulation: judgement, focus and stability* that – subject to a positive outcome of this consultation – any work on transferring consumer credit may progress on a longer timetable than the wider institutional reforms.

**5.13** Should the Government decide following this consultation to retain the CCA regime rather than to transfer to a FSMA-style regime for consumer credit regulation, it will consider the most appropriate regulatory authority for the CCA regime following the conclusion of the wider work on the future of the competition and general consumer functions of the OFT, and issue a further consultation on this if necessary. Further clarity on the timetable for this review will be issued with the Government response to this consultation.

## Devolved issues

**5.14** Financial services matters are reserved in Wales, Scotland and Northern Ireland and FSMA applies to the whole of the UK. Consumer credit matters are reserved in Wales and Scotland but consumer credit is a devolved (transferred) matter in Northern Ireland. However, the key consumer credit legislation which is relevant to this consultation (the Consumer Credit Acts 1974 and 2006 and associated regulations) applies to the whole of the UK. The Minister of Enterprise, Trade, and Investment for Northern Ireland has agreed that Northern Ireland be included in this consultation with a view to ensuring that Northern Ireland consumers can be consulted on any changes that may impact on their consumer credit legislation. At this stage, we are not consulting on detailed amendments to relevant legislation which might impact on devolved issues (including the Bills of Sale Acts which apply to England and Wales only). Any new or amended legislation passed at Westminster subsequent to this consultation will only apply to transferred areas if the consent is given by the appropriate devolved authority.

# A

## Core consumer protections enshrined under the CCA

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The following is an indicative list of the key consumer protection provisions in the Consumer Credit Act (CCA):

### Advertising/canvassing

- Controls on credit advertising (CCA sections 43-47)
- Ban on canvassing off trade premises (s48-49)
- Controls on credit brokers and credit intermediaries (s55 and 160A)

### Pre-contract

- Requirements on pre-contractual information (s55)
- Duty to give adequate explanations (s55A)
- Duty to assess creditworthiness (s55B)
- Right to request details of credit reference agency used to access consumer's credit file (s157-159)
- Key information about credit arrangements must be made available to consumers before the agreement is concluded or immediately afterwards (Part 5)

### Contract

- Form and content of credit agreements and provision of copy documents (s60-65)

### Withdrawal

- Cooling off, withdrawal and right to cancel (s66A, 67 and 68)

### Early payment/settlement and termination

- Right to full or partial early repayment on a fixed sum credit agreement (s94-95A)
- Right to terminate hire-purchase or conditional sale agreement (s99-100)
- Right to terminate open-end agreements, i.e. those with no fixed duration (s98A)

### Post-contractual disclosure

- Right to request a copy of the credit agreement and specific related information (s77-79)
- Right to request a statement of account in the form of an amortisation table (s77B)
- Provision of annual and periodic statements and arrears notices (s77A, 78, 86B and 86C)
- Notification of interest rate changes (s78A)

### Default /enforcement

- Provision of default notices and default sum notices (s86E, 87 and 88)
- Controls regarding enforcement of a debt or repossession of goods or land (s76, 90 and 98)
- Right to apply for a time order from the courts, which if successful, will provide consumers with more time to repay a loan (s129)

### Linked credit agreements

- Liability of creditors for consumer claims against suppliers (s75 and 75A)

### Unfair relationships/redress

- Unfair relationship test (s140A to 140D)
- Right to redress through Financial Ombudsman Service





# B

## Key features of the CCA and FSMA regimes

Licensing under CCA regime	Authorisation under FSMA regime
<ul style="list-style-type: none"> <li>• <i>Applications</i> for an OFT licence require information about applicant including criminal offences, director disqualification and financial integrity.</li> <li>• <i>High-risk activities</i>: Applicants are asked to provide additional information which demonstrates their competence to undertake high-risk activities; some high risk applicants also face an inspection visit.</li> <li>• <i>Assessing fitness</i>: Applicants are assessed against a test of 'fitness'. The concept of fitness is broadly defined; alongside assessment of integrity and competence issues, OFT can take account of evidence of unfair or improper business practices.</li> <li>• <i>Group licences</i>: The OFT may grant group licences to cover the credit activities of members of professional and other bodies rather than requiring individual firms to apply for a standard licence.</li> </ul>	<ul style="list-style-type: none"> <li>• <i>Applications</i> for FSA authorisation usually need to be accompanied by supporting material such as business plan, compliance procedures and balance sheet/ cash flow forecasts<sup>36</sup>.</li> <li>• <i>Threshold conditions</i>: These are minimum conditions that FSMA-authorised firms must satisfy and continue to satisfy in order to carry on a regulated activity.</li> <li>• <i>Approved persons</i>: Individuals who perform a role of particular regulatory significance must comply with standards covering 'fitness and propriety'.</li> <li>• <i>Appointed Representatives (AR) &amp; Professional Bodies</i>: An AR can carry on certain regulated activities without being authorised if entering into a contract with an authorised firm (known as the Principal) which accepts responsibility for regulated activities carried out by its AR(s). Members of the professions may carry on certain regulated activities under supervision and regulation of their professional body, with FSA maintaining oversight.</li> </ul>
CCA regime fitness standards and supervision	FSMA regime requirements and supervision
<ul style="list-style-type: none"> <li>• <i>Fitness and detailed legislative requirements</i>: OFT issues guidance on fitness, making clear the types of behaviour that may trigger regulatory action. Detailed requirements are set out in the CCA and its secondary legislation. Compliance with these forms the basis of assessing the ongoing fitness of licensees.</li> <li>• <i>Supervision of high risk sectors</i>: Sectoral approach focusing where intelligence suggests inappropriate business practices or actual/potential consumer harm. OFT also conducts regular compliance reviews on a sectoral basis.</li> <li>• <i>Information powers</i>: Licensees required to notify OFT of changes in key information underpinning their licence application. OFT also has range of information-gathering powers which may be exercised throughout the period of a licence.</li> </ul>	<ul style="list-style-type: none"> <li>• <i>Principles for businesses</i>: These are high-level rules that set out the fundamental obligations of all authorised firms (e.g. conducting business with integrity and due skill, care and diligence; and treating customers fairly).</li> <li>• <i>Specific conduct of business and prudential rules</i>: Most authorised firms must meet a general solvency requirement and minimum capital requirements and/or hold Professional Indemnity Insurance cover. FSA's conduct of business rules generally focus on product lifecycle and are consumer outcomes focused.</li> <li>• <i>Systems and Controls requirements</i>: Authorised firms must put in place systems and controls necessary to support the firm's activities and comply with relevant rules; and organise and control their affairs responsibly and effectively.</li> <li>• <i>Regular reporting</i>: Authorised firms are generally required to submit reporting returns on a regular basis. The level of detail and frequency depend on factors including the type of regulated activity.</li> </ul>

<sup>36</sup> For further details, see *Applying for authorisation*, Financial Services Authority, [http://www.fsa.gov.uk/pubs/other/applying\\_authorisation.pdf](http://www.fsa.gov.uk/pubs/other/applying_authorisation.pdf).

### Enforcement under CCA regime

- *Licensing sanctions:* OFT has wide powers to take action against traders, e.g. to refuse/ revoke licence; impose tailored conduct requirements; and impose civil penalties of up to £50,000 per breach of requirements.
- *Criminal offences:* CCA provides for a number of criminal offences but criminal prosecutions are relatively rare<sup>37</sup>. OFT and Trading Standards Services can also use wider consumer enforcement powers such as CPRs.
- *Unenforceability:* Certain breaches of the CCA by creditors, including unlicensed trading, may mean the credit agreement is unenforceable unless a court or the OFT orders otherwise.<sup>38</sup>

### Enforcement under FSMA regime

- *Enforcement provisions:* Broader range of specific sanctions than the CCA regime, including potentially higher fines on firms/ individuals; prohibiting individuals from working in financial services or carrying on particular activities; public censure of firms/ individuals. Carrying on regulated activities without authorisation is a criminal offence. However, breach of a rule does not constitute a criminal offence, nor does it make a transaction void or unenforceable.

<sup>37</sup> The OFT shares its powers to enforce breaches of the CCA with Trading Standards Services in Great Britain and with the Department for Enterprise, Trade and Investment in Northern Ireland.

<sup>38</sup> Certain provisions before amendments made by CCA 2006 provided for unenforceability without a power for the court to set it aside.



# Consumer borrowing covered by the CCA, FSMA and self-regulatory codes

Regime	Borrowers covered	Conditions
Consumer Credit Act	Individual consumers Sole traders <sup>39</sup> , small partnerships and other unincorporated bodies	Unsecured loans and second charge mortgages Unsecured loans and second charge mortgages up to £25,000
Financial Services and Markets Act	Individual consumers, sole traders and unincorporated partnerships	All first charge mortgages where the loan is secured by a first charge on a residential <sup>40</sup> property <sup>41</sup>
The Lending Code	Consumers, micro-enterprises <sup>42</sup> and charities with an annual income or turnover of less than £1 million	Loans provided by Lending Code subscribers, but not non-business borrowing secured on land or sales finance
The Finance and Leasing Association (FLA) Lending Code	Consumers	All consumers who have taken out a consumer credit loan with an FLA member regardless of its value
The FLA Business Finance Code	Businesses and the public sector	The Code sets out the standards that FLA members will meet when providing asset finance to businesses and the public sector

*Source: Department for Business, Innovation and Skills internal research*

<sup>39</sup> Defined as operating as an individual without the use of a company structure or partners and has sole responsibility for the actions of the business.

<sup>40</sup> 'Residential' in this context means that at least 40% of the land is used (or intended to be used) as a dwelling by the borrower or a family member (e.g. it is not a buy to let property).

<sup>41</sup> The detailed mortgage conduct of business rules and the Financial Ombudsman Service do not apply where the borrowing is to a business with a turnover of more than £1 million per year.

<sup>42</sup> A micro-enterprise is a business that employs fewer than 10 employees and has turnover that does not exceed 2 million euros.



# D

## Glossary of terms

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**Bills of Sale:** The Bills of Sale Acts are Victorian legislation governing the legal effect of documents that transfer a property right to personal goods to the lender as security for a loan.

**Consumer Credit Act 1974 (CCA):** The CCA, as substantially amended by CCA 2006 and in 2010 as a result of the Consumer Credit Directive, requires most businesses that offer goods or services on credit or lend money to consumers to be licensed by the Office of Fair Trading. Trading without a licence is a criminal offence. The CCA also sets out rules governing the conduct of lenders and intermediaries and the forms and content of regulated agreements, as well as providing rights for the protection of consumers (see Annex A).

**Consumer Credit Directive (CCD):** The CCD was adopted by the EU in 2008. It aims to create a common credit market across the EU in a number of core areas and to ensure high levels of consumer protection.

**Consumer Financial Education Body (CFEB):** CFEB is an independent body, created in April 2010 by the Financial Services Act 2010, which is responsible for helping consumers understand financial matters and manage their finances better. It provides impartial information, education and advice through a national financial advice service.

**Consumer protection and markets authority (CPMA – this is a working title):** As part of proposals to reform the institutional framework for financial regulation in the UK, the Government has announced the creation of a dedicated consumer protection and markets authority as the single integrated conduct regulator. The CPMA will have a primary objective of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity.

**Consumer Protection from Unfair Trading Regulations 2008 (CPRs):** The CPRs are the UK rules that implement the EU Unfair Commercial Practices Directive 2005/29. They introduce a general duty not to trade unfairly and seek to ensure that traders act honestly and fairly towards their customers. They prohibit unfair practices affecting consumers, including misleading actions and omissions and aggressive practices.

**Debt Managers Standards Association (DEMESA) Code:** This voluntary code is overseen by DEMESA and approved by the Office of Fair Trading. It seeks to encourage member firms engaged in debt management to provide high standards of service and conduct.

**Enterprise Act 2002:** The Enterprise Act 2002 made amendments to the consumer, competition and insolvency regimes. It establishes the Office of Fair Trading in its present form and includes additional provisions for the enforcement of consumer law where it affects the collective interests of consumers including in relation to consumer credit and other financial services.

**Finance and Leasing Association (FLA) Lending Code:** The FLA Lending Code is a voluntary code which sets out standards of good practice in relation to loans provided by their members.

**Financial Ombudsman Service (FOS):** The FOS is a public body set up in statute. It is the official independent complaints scheme which works to resolve complaints between consumers and businesses providing financial services.

**Financial Services Authority (FSA):** The FSA is currently the UK financial services regulator. In July, the Government announced reforms to the institutional framework for financial regulation and intends to create a Financial Policy Committee in the Bank of England; a new Prudential

Regulation Authority as a subsidiary of the Bank of England; and a consumer protection and markets authority.

**Financial Services and Markets Act 2000 (FSMA):** The FSA's powers, duties and functions are primarily set out in FSMA.

**Financial Services Compensation Scheme (FSCS):** The FSCS is the UK's statutory fund of last resort for customers of FSA-authorized financial services firms. The FSCS can pay compensation to consumers if a financial services firm is unable, or likely to be unable, to pay claims against it. The FSCS is an independent body, set up under FSMA.

**Grandfathering:** the possibility that persons licensed by the OFT immediately before a possible change in the regulatory regime (should the regulation of consumer credit be transferred to the CPMA) may continue to operate under the new rules despite not having an authorisation under these new rules.

**Lending Code:** The Lending Code is a voluntary code of practice for banks, building societies and credit card companies which sets standards for financial institutions to follow when they are dealing with their consumer and micro-enterprise customers and with charities with an income of less than £1 million.

**The Lending Standards Board:** The body that supervises the Lending Code.

**Micro-enterprise:** Under the definition adopted in EU law (Commission Recommendation 2003/361/EC), a micro-enterprise is a firm which employs fewer than 10 people and whose annual turnover and or balance sheet does not exceed EUR 2 million.

**Office of Fair Trading (OFT):** The OFT is the UK's independent consumer and competition authority. Its mission is to make markets work well for consumers. For government accounting purposes, it is categorised as a non-ministerial government department. It has a range of powers and duties, including administering and enforcing the CCA. In October it was announced that its competition and general consumer functions are being reviewed as part of the Public Bodies Bill process.

**Public Bodies Bill:** This Bill was announced on 14 October 2010 and sets out the Government's plans to reform the functions of many public bodies.

**Retail financial services:** Services such as current accounts, payments, personal or mortgage loans, savings, pensions, investments or insurance products, when they are provided to individual customers, including investors.

**Small and Medium sized Enterprises (SMEs):** Under EU law (Commission Recommendation 2003/361/EC) a small enterprise is defined as an enterprise employing fewer than 50 personnel and whose annual turnover and or balance sheet total does not exceed EUR 10 million. A medium enterprise is defined as an enterprise employing fewer than 250 personnel and whose annual turnover and or balance sheet does not exceed EUR 43 million.

**Self-regulation:** This is the practice whereby regulation is not imposed by Government or regulators, but is undertaken voluntarily by firms, usually under the auspices of trade associations.

**Local Authority Trading Standards Services (TSS):** TSS are partners in the delivery of the consumer law regime. They have powers to enforce a range of consumer law, including the CCA, the CPRs and weights and measures legislation. They are funded by, and are accountable to, local authorities. TSS collaborates on a regional basis in the delivery of the specialist Illegal Money Lending enforcement teams in England, Scotland and Wales.

**Unfair Terms in Consumer Contract Regulations 1999 (UTCCRs):** The UTCCRs protect consumers against unfair standard terms in contracts they make with traders.

# E

## List of consultation questions

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### Chapter 1

1. Do you agree with this assessment of the consumer credit market?
2. Is this a fair assessment of the problems caused by the way in which consumer credit is currently regulated and issues that may arise as a result of the split in responsibility for consumer credit and other retail financial services?
3. The Government would welcome further evidence relating to the consumer credit regime, including in particular:
  - the types of risks faced by consumers in consumer credit markets;
  - key provisions for consumer protection under the current regime and their effectiveness in securing appropriate outcomes for consumers; and
  - the incidence of regulatory duplications or burdens on firms and/or inconsistent regulation of similar types of business.
4. Do you consider these objectives for reform of the consumer credit regime to be appropriate and attainable?

### Chapter 2

5. The Government welcomes views on the impact a unified regulatory regime for retail financial services may have in terms of clarity, coherence and improved market oversight.
6. The Government welcomes views on the role of institutions other than the OFT in the current consumer credit regime, and the benefits they may confer.
7. The Government welcomes views on factors the Government or the CPMA may wish to consider in the event of a transfer of consumer credit regulation relating to how the overall level of consumer protection might best be retained or enhanced.
8. The Government would welcome further evidence relating to:
  - the use of consumer credit by small and medium sized enterprises (SMEs);
  - whether the protections currently afforded by the CCA are appropriate and cover the right groups of businesses; and
  - the costs and benefits of considering extending FSMA-style conduct of business rules to a wider group of SMEs.
9. The Government welcomes views on how consumer credit firms and consumers may be affected by the increased flexibility that could be provided by a rules-based regime.
10. The Government welcomes views on the impact a FSMA-style supervisory approach may have in terms of ensuring effective and appropriate consumer protection.

11. The Government welcomes views on the synergies afforded by the current regime in tackling problems associated with the sale of goods and services on credit, and how these might best be retained in the design of a new regime.
12. Do you agree that transferring consumer credit regulation to a FSMA-style regime to sit alongside other retail financial services regulation under the CPMA would support the Government's objectives (as outlined in paragraph 1.18 of Chapter 1)?
13. Are there other advantages or disadvantages that you consider could result from transferring consumer credit regulation to sit alongside that of other retail financial services?
14. Are there specific issues that you believe the Government should consider in assessing the merits of option 1? How could these be addressed in the design of a new regime as proposed in option 1?
15. If you do not agree with the Government's preferred option 1, do you have views on the factors set out in paragraph 2.4 that the Government should consider in determining the most appropriate regulatory authority for the CCA regime under option 2?

### Chapter 3

16. The Government welcomes views on the suitability of the provisions of a FSMA-style regime, such as those referred to in paragraph 3.6, to different categories of consumer credit business.
17. Do you agree that statutory processes relating to CPMA rule-making, a risk-based approach to regulation and differentiated fee-raising arrangements could provide useful mechanisms in ensuring that a proportionate approach is taken to consumer credit regulation under a FSMA-style regime?
18. The Government welcomes views on key factors that would need to be assessed in considering fee arrangements for consumer credit firms.
19. The Government welcomes:
  - evidence relating to experiences of the current appointed representatives regime;
  - views on how an appointed representatives model might be applied to different categories of consumer credit activities, including how current business models and networks might lend themselves to such an approach; and
  - evidence relating to the implications an appointed representatives regime might have for firms and consumers.
20. The Government welcomes:
  - evidence relating to experiences of the current group licensing regime; and
  - views on how the professional bodies regime might be adapted for different categories of consumer credit activities.
21. The Government welcomes views on the extent to which self-regulatory codes might continue to deal with aspects of lending to consumers and small and medium enterprises.
22. Do you consider that there would be a case for deregulation of certain categories of consumer credit activity in the event of a transfer? Please explain why.
23. Are there other ways in which the design of a new consumer credit regime based on a FSMA-style framework might ensure a proportionate and effective approach?



## Chapter 4

24. The Government welcomes views on how the treatment of agreements already in existence could be approached.

25. The Government welcomes views on:

- how existing licensees could be dealt with; and
- factors that should be considered in determining whether a modified approach could be adopted for particular categories of licensed firms.

26. The Government welcomes views on key factors that would need to be considered in transitioning from the current to a new fee structure.

27. Are there other factors the Government should take account of in considering transitional arrangements?

28. The Government would welcome evidence on the experience of firms, consumers and their representatives in relation to similar previous transitions, for example the extension of FSA jurisdiction to new markets since 2000.



# F

## Code of Practice for written consultation

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**F.1** This consultation process is being conducted in line with the Code of Practice (<http://www.berr.gov.uk/files/file47158.pdf>) which sets down the following criteria:

- When to consult. Formal consultation should take place at a stage when there is scope to influence the policy outcome.
- Duration of consultation exercises. Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- Clarity of scope and impact. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- Accessibility of consultation exercises. Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- The burden of consultation. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- Responsiveness of consultation exercises. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- Capacity to consult. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

**F.2** If you feel that this consultation does not fulfil these criteria, please contact:

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This document can be found in full on our website at:  
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