Roadmap to the FCA

A new settlement for consumers of consumer credit

A paper commissioned by StepChange Debt Charity

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Foreword

StepChange Debt Charity is the UK's largest specialist provider of free, independent debt advice, helping around 1,500 people a day. Personal debt is still a significant social problem in the UK with around six million households currently in, or at risk of financial difficulty. Our experience of dealing with debt problems over the last twenty years tells us that more can be done to prevent unmanageable debt and to reduce the costs and consequences of debt problems where they occur.

Therefore we welcomed the government's decision to create a new regulatory regime for consumer credit. Credit is generally a force for good, but the experience of our clients tells us that there is still a strong link between the conduct of consumer credit firms and problem debt. Poor lending decisions, unfair and unsuitable product features, aggressive debt collection and excessive default fees can all cause or contribute to serious financial difficulties.

The Financial Conduct Authority (FCA) will take responsibility for consumer credit in April 2014 and we are confident that the new regime will succeed in preventing and easing some of the serious problems that many of our clients have suffered for too long. A fair, competitive, credit market where consumers are properly protected from bad practice and unfit traders is perhaps within touching distance. But the FCA will need to get the rules and the regulatory approach right and do so from day one.

We have commissioned this independent report to aid this discussion. It aims to highlight some of the key early challenges we believe that the FCA will face, to set some milestones for change, and to consider how the FCA might best use its powers to ensure that credit markets work well for consumers. We hope the report stimulates debate and helps the FCA to deliver a regulatory regime that can minimise problem debt in the UK.

The views set out are the author's own and do not necessarily represent the views of StepChange Debt Charity.

Summary and introduction

As we transition through to the new FCA regulatory regime for consumer credit, and in light of recent technological advances making credit more easily accessible for the mass market and low income consumers, invariably questions of whether there should be a new settlement for consumer credit and credit related services will be asked. At the heart of the debate is where to set the regulatory bar, owing to some forms of credit that operate on the margins or where access to credit and issues of affordability tend to be mutually reinforcing. However, when consulting on legal rules, there is often a tendency to become caught up in the process and lose sight of what it is a regulatory framework is actually being designed to achieve.

There are many longstanding issues with those parts of the credit market where consumers are susceptible to unscrupulous practices such as loan sharks, with a prevailing view among some that bad credit is preferable to loan sharks. But bad credit is simply that, bad credit and whilst FCA regulation should be designed to be flexible and proportionate, there will be firms who, quite rightly, will not be able – and should not then be permitted - to provide credit or credit related services under the new requirements.

Appropriate regulatory costs are an inherent part of establishing and running a reputable business. Those who are not interested in establishing good standards of business should not then be in the business of providing credit or credit related services to consumers. Where firms are clearly unwilling to meet the FCA's Threshold Conditions, applicable from 1 April 2014, and thereafter the FCA's regulatory rules, costs to business should not be used as an excuse for authorising businesses that provide poor outcomes for consumers or that lack financial stability. Those who operate in high cost credit markets in particular should demonstrate a strong willingness to complying early with FCA requirements given the sense of urgency that often surrounds the financial needs of their customer base.

Because many people across credit markets can quickly veer towards financially vulnerability, where even a relatively gentle 'shock' to their finances is enough to prevent them from maintaining financial repayments, the FCA, for its part should pay particularly close attention to whether there are firms who simply view their customers as 'easy pickings', rather than providing appropriate levels of service and ensuring that their customers are treated fairly.

Set out in this paper, and attached at Annex 1 and 2, are problem areas presented as case studies, which the OFT regime has been unable to completely get to grips with, alongside a roadmap of why, how and when the FCA should seek to use its powers and be far more dynamic in its engagement with the credit industry. Specifically, this paper looks at payday lending, which exemplifies what is happening across different credit markets more generally, turning later to the debt management and debt collection sectors.

Clearly, as the FCA undergoes the transition to regulate consumer credit, many challenges lie on the road ahead. Expectations of the FCA are high. Resources are undoubtedly going to be stretched, resulting in industry calls for the FCA to move more slowly. Yet, with levels of consumer detriment across credit, debt management and debt collection rising every day, there is a pressing need to act sooner, not later, with transition to the FCA offering a singular opportunity to finally clean up credit and improve its market competitiveness.

Using the whole range of powers it has in its toolkit, the FCA should:

- Act early, effectively and robustly, ensuring all creditors lend responsibly
- Plug enforcement gaps through prompt firm reporting of transactional data, from day one
- Cap charges of debt management firms, imposing temporary product intervention rules, from day one
- Make all high cost credit business, products and services suitable for the needs of customers, by end 2014
- Stop debt spirals by freezing interest, default fees and all other charges when consumers are in financial difficulty, and by introducing a 'debt escalation cap' by mid 2015
- Ensure the total cost of credit, default fees and other charges are transparent, before 2016
- Clamp down hard on misleading advertising across debt management, and on aggressive debt collection, employing local solutions from day one

Key lines for payday lending

- There is less than a year to go to the FCA regime and the government should not be allowing today's problems in credit markets to become more intractable problems for tomorrow
- Since the payday business model is effectively shaped by the product design, using the Firm Systemic Framework, the FCA should ensure that payday lenders are responding to customer's needs. This requires immediate attention
- The authorisation of payday lenders should be an FCA priority so that they are fully authorised before the end of 2014
- The high cost credit industry needs to demonstrate that it is complying with existing Money Laundering Regulations with compliance monitoring from day one, and will be able to comply with the FCA's high level Principles for Business
- The FCA should fill an enforcement gap by ensuring all high cost lenders - whether higher or lower risk with limited permissions - report a minimum level of transactional information, and preferably in real time
- Given the multiplicity of loans held by individual consumers, there is merit in data sharing for payday lenders
- The FCA should consult on what would be appropriate data reporting for credit firms in its forthcoming Senior Management Arrangements, Systems and Controls (SYSC) and rulebook consultation papers in the Autumn
- The FCA's investigation into whether payday lenders are inappropriately targeting vulnerable consumers is timely, and the FCA should further clamp down hard on lenders who advertise 'No credit checks'
- When a payday loan is rolled over this should be used by lenders as an indication of financial difficulty
- The FCA should invoke new s137C of the FSMA to limit the number of payday rollovers to one, from day one
- Over the coming months, the OFT, FCA and industry should work together to develop new

formats for the presentation of the total cost of credit, default and other charges, enabling consumers to exert a downward pressure on costs and make the credit market work more effectively. This might include a Code provision but should, in any event, include consideration of a total cost of credit over a set number of days

- The OFT referral of the payday lending sector to the Competition Commission is a welcome development. The Commission investigation will provide valuable insight into how best to achieve transparent competition in a sector that is currently not delivering positive outcomes for consumers
- The FCA should provide timely reports on firms' practices, particularly those of payday lenders, concerning CPA cancellation in 12 months time

Key lines for debt management

- The FCA should undertake a thematic review of the charging practices of fee charging debt management firms, before they are fully authorised
- Working with consumer and debt advice groups, the FCA should impose a Temporary Product Intervention Rule (TIPR) under new s138M to cap the charges of debt management firms as a percentage (%) of the money that is available to repay debts
- Working with consumer and debt advice groups, the FCA should give consideration to how it can improve charge transparency for consumers across the debt management sector
- As in the payday lending sector, debt management firms should be prioritised for authorisation by the FCA
- The problems identified across debt management through the StepChange Debt Charity Social Policy Network should be tackled by the FCA by its drafting of COB rules
- COB rules will need to be reasonably specific, albeit it may be possible to capture some of the balance of regulation (eg. relating to data reporting) under the FCA's high level Principles and SYSC. Detailed comment on the draft rules will be provided by StepChange Debt Charity once the FCA publishes its consultation document in the Autumn
- The FCA should clamp down hard on misleading advertising and the other bad practices identified in the debt management sector by consumer groups from day one

Key lines for debt collection

- The FCA should impose COB rules to freeze interest, default fees and other charges where consumers can demonstrate they are experiencing financial difficulty
- The FCA should work with consumer groups to undertake data modelling of the types of debt actually being experienced by consumers, and introduce a debt escalation cap to stop debts from spiralling out of control, by mid 2015
- A debt escalation cap should seek to prevent severe detriment and build from existing good practice such as Budget Guidelines, the Common Financial Statement and other debt advice tools used by the not-for-profit debt advice sector
- It would be helpful to know why the FCA considers rules for advised sales to be important for the sale of mortgages but not for the sale of debt solutions
- The FCA should establish an 'early intervention' working group of representatives drawn from across consumer groups, the not-for-profit debt advice sector and industry firms to report back within nine months before firms are fully authorised
- The problems identified across the debt collection sectors through the StepChange Debt Charity Social Policy Network should be tackled by the FCA by its drafting of COB rules

- Again, COB rules will need to be reasonably specific. StepChange Debt Charity will provide further comment on these once the FCA publishes its consultation document in the Autumn
- At its simplest and basic level, all debt collection firms should be communicating with their customers in a non-threatening, professional manner, taking into account a customer's mental health. The FCA should quickly undertake a product governance and literature review of customer communications
- Since debt collection agencies are a broad church comprising disparate and often very small firms, funding could also be made available for certain aspects of work to be undertaken by employing local Trading Standards Services

Roadmap to the FCA

The FCA has a wide range of powerful tools in its toolkit to tackle the bad behaviour of firms. These include preventative measures such as the FCA's high level Threshold Conditions for authorisation, high level Principles for Business and Temporary Product Intervention Rules (TPIRs),[1] as well as the more traditional punitive measures usually associated with regulation, such as the power to impose unlimited fines, public censure, suspend permissions and withdraw approvals.[2]

Because the FCA is proposing a proportionate regime for the regulation of consumer credit, however, there are a number of key decisions that still need to be made about how precisely the FCA should prioritise its activities, and broader regulatory approach, as it starts the task of authorising credit and credit related firms while also finalising its rulebook. This is partly owing to some of the key provisions consumer groups and others would want credit firms to follow already being set out among a diverse mix of FCA conduct of business rules (eg. MCOB or COB rules), industry codes of practice or industry guidance, but, more importantly, because of the FCA's new, more intrusive approach to regulation. Adding all of these considerations together with how best to tackle longstanding problems in credit markets, as well as the new, evolving forms of credit increasingly reliant on wi-fi internet enabled devices, there are an enormous number of competing demands that will require attention if the FCA is ever to get onto the front foot.

The FCA's own Financial Risk Outlook says,

"Particular attention should be paid to serving existing clients and the search for new income streams [by focusing on] specifically the security of your technology, testing models for treating customers fairly and how you ensure operational security."

At the heart of the debate lies the ease by which consumers can access credit, the excessive charges often added onto credit and credit related services, both before sale, after sale and on default, but especially when consumers fall into financial difficulty, coupled with the total disregard some providers have to lend responsibly or to treat their customers fairly. Indeed, evidence suggests that some firms actually seem to wholly rely on excessive default charges and/or misleading and aggressive practices as their basis for making profit rather than on the provision of good products or credit services, which must surely raise alarm bells about business ethicacy.

Set out in this paper, and attached at Annex 1 and 2, are problem areas presented as case studies which the OFT regime has been unable to completely get to grips with, alongside a roadmap of why, how and when the FCA should seek to use its powers and be far more dynamic in its engagement with the credit industry. Specifically, this paper looks at payday lending, which exemplifies what is happening across different credit markets more generally, turning later to the debt management and debt collection sectors.

1 Introduced by the Financial Services Act 2012, see FSMA new section 138M

2 FSMA Part XIV – ss.205-211

1 Payday Lending

Threshold conditions, business models and product design

In the payday lending sector, OFT investigations and depth research undertaken by consumer groups all point to a similar range of problems which appear to largely stem from the underlying business model and product design of many payday lenders. The OFT's recent high cost credit survey, for example, found that out of 190 responses, it is estimated that between 7.4 and 8.2 million new payday loans were issued in 2011/12, with the total value of these being between £2.0 and £2.2 billion (up from £900 million in 2008), and the estimated total turnover being £860 million. Considering that the estimated total turnover for payday loans was £220 million in 2009/10, this represents an almost 400 per cent increase in total turnover. But, when taking into account the total value of new loans in 2011/2012, the OFT data further found that the turnover derived from basic lending fees and charges was between £435 and £470 million, representing 59 to 64 per cent of total payday revenue. Or, in other words, between 36 and 41 per cent of payday revenue came from 'rollover' fees, default fees and other administrative charges.

StepChange Debt Charity also reports that the average payday loan debt of its clients has increased from £1,220 in 2010 to £1,657 in 2012 (in total amounting to over £60 million worth of debt) with the average payday loan debt now exceeding the average monthly income of clients with this type of loan (£1,320). Furthermore, 65 per cent of clients have contractual payments worth more than 100 per cent of income compared to 14 per cent for all other clients, causing extreme detriment owing to high repayment costs.[3]

Similarly, Which? research carried out in May this year, shows that despite the difficult economic climate (net household incomes have fallen by 13.2 per cent in real terms[4] since the onset of the recession) consumers appear increasingly over-optimistic about their ability to repay, with 48 per cent of the payday loan users surveyed[5] having taken out credit in the past that they couldn't then afford to repay. Which? goes on to report that lenders are not making their charges clear or taking sufficient account of people's ability to repay before granting, extending or increasing a loan. And, even where account is taken of a person's ability to repay, given the high levels of default fees, this could still result in inappropriate levels of borrowing, with consumers then becoming quickly locked into a spiral of escalating debt.

The FCA's recent consultation for its high level proposals for an FCA regime for consumer credit confirms that payday lenders will be broadly classified as being higher risk firms. But, given the ongoing endemic problems being highlighted by the OFT and consumer groups in the payday market, where exactly to set the regulatory bar should (for the moment at least) be less clear. Compliance with existing industry codes of practice or guidance, may well be one

3 StepChange Debt Charity Statistical Yearbook, 2012, p18-19

4 According to the Office for National Statistics

5 Populus on behalf of Which?, surveyed 4,031 GB adults online (of which 3,195 were credit users for its Which? Credit Britain survey, August 2012

of the determining factors in the award of an FCA permission, yet it should not necessarily follow that a firm's adherence to an industry code or guidance should guarantee that they receive FCA permission; and, where firms do not comply with any code of practice or guidance at all, even less so.

This is because before becoming FCA regulated, providers of consumer credit will need to meet more stringent Threshold Conditions imposed on them as part of the FCA's authorisation regime, including the need,

"to demonstrate that the firm's affairs are conducted in an appropriate manner regarding the interests of consumers and the financial integrity of the UK financial system".

Under the new FCA regime therefore all higher risk firms will be required to submit detailed business plans where the firm's strategy for doing business must be suitable for its regulated activities having regard to the FCA's operational objectives.

As the FCA points out "When we assess a firm's application, the size of a firm will play a part in how intrusive we are. However, making sure our approach is proportionate is more to do with assessing the risks of a particular business model to consumers"[6] as aligned with the Firm Systemic Framework (FSF)[7] which is used to answer the question: are the interests of customers and market integrity at the heart of how the firm is run? This will include consideration of whether product design is responding to customers' needs or long term interests set alongside product governance processes that ensure appropriate consumer outcomes. It is also meant to be reflective of the FCA's more intrusive approach to the supervision of firms more generally which will rely far more on the use of forward looking analysis, firm intelligence and data.

Both in legal and practical terms then, the concerns of the OFT and consumer groups about the business models and product design of payday lenders will need to be considered in the context of the FCA's high level requirements, and more particularly, what it is that credit firms will need to be doing to demonstrate that they meet the FCA's Principles for Business, Principles 3 and 6.

Prin 2.1.1

(3) A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems

(6) A firm must pay due regard to the interests of its customers and treat them fairly *(Treating Customers Fairly)*

Principle 3 relates to the controlled, and significant influence, functions performed for a firm by a person who must be first vetted as 'fit and proper' by the FCA as an Approved Person, to ensure that there is at least one individual responsible for firm compliance and the proper functioning of the firm's internal systems and controls. These are referred to in the FCA Handbook as Senior Management Arrangements, Systems and Controls or SYSC for short. SYSC rules, in turn, are designed to ensure that the directors and senior management of regulated firms have clear lines of responsibility so that the business will be effectively and properly monitored on an ongoing basis.

The areas covered by SYSC include having in place proper processes and systems for firm governance, internal audit, record keeping, risk assessment and scrutiny of management information, with SYSC 6.3.6, for example, directing firms to collect relevant business data or management information to identify whether there are any risks to a firm's business integrity owing to money laundering

SYSC 6.3.6

In identifying its money laundering risk[8] and in establishing the nature of these systems and controls, a firm should consider a range of factors including:

(1) its customer, product and activity profiles

(2) its distribution channels

6 See CP13/7 High level proposals for an FCA regime for consumer credit

7 The Firm Systemic Framework extends to all firms in three of the four risk categories: large retail banking and insurance firms (which the FCA call Category 1 or C1 firms); firms in all sectors with a large retail customer footprint or wholesale market presence (C2), and mid-sized firms across all retail and wholesale sectors (C3). The FSF will not extend to Category 4 (C4) firms: retail and wholesale firms with a smaller footprint

8 See also Money Laundering Regulations 2007

(3) the complexity and volume of its transactions

(4) its processes and systems, and its operating environment

Having proper systems capability then not only enables firms to prove to the FCA that it is managing its operational and financial risk, but these self same systems and controls are a means for firms and the FCA to also monitor, measure and challenge how the firm and its employees integrate high level Principle for Business 6, (or treating customers fairly) into their business culture.

The detailed rules and guidance in relation to Approved Persons and SYSC for credit firms will be included as part of the FCA's further consultation on credit regulation scheduled for September 2013. However, although the FCA has said in its recent high level consultation that its proposals for granting "an interim permissions regime should see improved standards in the consumer credit market because firms will have to comply with FCA rules," the FCA has also said that it "does not propose that firms will have key individuals pre-approved by us to hold an interim permission and neither should they have to provide the FCA with regulatory information." This is in spite of the FCA's intention to take forward the supervision of credit firms on an 'event driven' or 'issues based' basis.

Yet, if firms do not have in place the necessary systems to report data promptly to the FCA from day one, which is, already a requirement under the Money Laundering Regulations 2007[9], it is highly questionable just how effective the FCA will be when it starts to authorise payday firms, or just how quickly it will be able to undertake any enforcement activity once the new regime takes effect. Will consumers, for example, be waiting yet another two years for a clean and competitive credit market?

The FCA's approach to interim permissions could therefore mean that lenders who simply do not apply for authorisation until their interim permission expires will have a 'free ride'; being permitted to carry on trading fundamentally just as they are, despite the overwhelming concern consumers and consumer groups have today about payday loans.

For a regulator that is committed to resetting standards across retail financial markets, it is extremely hard to reconcile this approach with how it intends to supervise firms in the future. But, more importantly, it points toward an urgent need for the FCA to revisit its policy for interim permissions, instead giving priority to the full authorisation of payday lenders and removing their interim permissions early.

- There is less than a year to go to the FCA regime and the government should not be allowing today's problems in credit markets to become more intractable problems for tomorrow
- Since the payday business model is effectively shaped by the product design, using the Firm Systemic Framework, the FCA should ensure that payday lenders are responding to customers' needs. This requires immediate attention
- The authorisation of payday lenders should be an FCA priority so that they are fully authorised before the end of 2014

SYSC and COB rule convergence on responsible lending

Aside from internal governance and managing operational risk, SYSC rules are also relevant to credit lenders more generally. Under the Consumer Credit Act, all credit lenders are legally required to assess creditworthiness before issuing a loan or increasing a credit limit. Under current Guidance, the OFT considers this must be based on sufficient information obtained from a borrower (customer and transaction data) where appropriate and from a credit reference agency where necessary, meaning that it is for lenders to decide whether to use a credit reference agency or otherwise when issuing their loans. To assist firms in their interpretation of creditworthiness, the OFT's

9 OFT Core Guidance, Money Laundering Regulations 2007, May 2009, OFT 954, page 14, para 3.1 businesses are required to establish and maintain risk sensitive policies and procedures relating to: customer due diligence measures and ongoing monitoring; reporting; record keeping; internal control; risk assessment and management; the monitoring and management of compliance with and internal communication of such policies and procedures

Irresponsible Lending Guidance further states that firms should be assessing affordability – that is, each borrower's ability to repay in a sustainable manner or potential for that specific credit commitment to impact adversely on the individual borrower's financial situation. However, in spite of OFT Guidance, evidence of irresponsible lending is still prevalent across credit markets, particularly payday.

When considering how to frame FCA regulation for credit worthiness, existing MCOB 11 and the BBA Lending Code both contain similar provisions aimed at underpinning responsible lending. MCOB focuses on firms having in place proper policies and procedures to demonstrate that they have taken account of the customer's ability to repay: with the Mortgage Market Review (MMR) rules that will take effect from the 26th April confirming that firms do not prescribe what is affordable, rather they require lenders to take several factors into account.[10] The Lending Code, on the other hand, is primarily concerned with the way in which banks, building societies and credit card providers (its Code subscribers), make use of their customer transaction data and requires lenders to carry out credit checks by using credit reference agencies (CRAs).

It is further notable that the OFT's recent compliance review found that payday lenders make less use of CRAs, but where an industry consensus is starting to build for payday lenders to share loan data.

The FCA for its part suggests that in complying with its Threshold Conditions, higher risk credit firms, should report a minimum number of measures including firm turnover, transaction information and complaints information, with the possibility of reporting being extended to include some additional information such as individual product sales data, total value of loan book and the numbers of customers in default. And, were firms to report additional data, this is an area where FCA Threshold Conditions and SYSC rules would, in effect, start to converge with existing COB requirements for responsible lending.

FCA regulated firms such as banks, insurers and investment houses and their intermediaries who are engaged in retail sales activities, are also already required by the FCA to submit regulatory returns such as SUP 16.11[11] to report Product Sales Data. SUP stands for 'Supervision' with the requirements of Sup 16.11 being extensive and covering a wide variety of retail products, including: bonds, structured products, unit trusts, pension annuities, individual and group personal pensions; fixed rate, discounted rate, interest only, tracker, capped and standard mortgages; and, pure protection products for critical illness cover and income protection. The specific data fields for mortgages can be found in Sup.16. Annex 21 R[12] and contain a mix of data aimed at understanding customer profile such as employment status, total gross income and method of repayment as well as the make up of the mortgage market.

Following the MMR, the FCA has recently been consulting on whether firms should also report enhanced affordability data, having decided that the data otherwise would be too limited to enable any meaningful analysis of firm compliance with the FCA's responsible lending rules. The proposed additional affordability data still includes customer profile and income data, but this will also now be set against details of a customer's expenditure and further stress tested against rising costs and rising interest rates:

Customer profile

number of borrowers

number of adults in household, and number of dependants (adults and dependent children)

second borrower employment status

Income

income details (for first, second, and third and subsequent borrowers)

gross basic pay, other income from main job (e.g. bonus and overtime)

10 including income, committed expenditure (eg. contractual payments) and, basic expenditure and costs of living

11 http://media.fshandbook.info/Forms/sup/sup_chapter16_annex20g_20100630.pdf

12 http://media.fshandbook.info/Forms/sup/sup_Chapter16_annex21r_20130401.pdf

income from self-employment and other income (e.g. pension, second job)

total net income used in the affordability assessment for each borrower

Expenditure

total outstanding credit commitments for all borrowers, and total monthly payments

other committed expenditure (e.g. child support and maintenance)

basic essential expenditure, and basic quality of living costs for the household (actual or estimated)

Stress testing

the interest rate used to stress test affordability

the amount of debt consolidated

the planned retirement age of first and second borrowers

whether the transitional arrangements have been used

In light of the FCA's future approach to supervision, just as enhanced affordability data is considered necessary for determining whether mortgage providers are adhering to COB affordability rules, it seems clear that unless appropriate credit lending data is also reported to the FCA, the FCA cannot be effective in ensuring that lenders are lending responsibly. Given the speed and ease of access by which payday loans are made available to consumers, it would seem sensible for the FCA to explore data sharing and real time data reporting for payday lenders.

With respect to lower risk firms, or those with limited permissions, however, the FCA considers that these firms will not have to meet as stringent Threshold Conditions or SYSC as higher risk firms, having decided to rely on self-certification and automated intelligence checks that adhere to industry best practice for firm compliance (see SYSC 7.1.2A). A flexible and proportionate regulatory regime may well mean that some FCA requirements can be relaxed and industry best practice prevail. Yet even for many limited permissions firms there is still a question of what should this industry best practice look like as well as the amount of FCA attention or resource these lower risk firms should receive. Many log book loan providers, for example, advertise themselves as undertaking 'No credit checks' at all so it does not necessarily follow that firms classified as lower risk should receive little or no FCA supervisory or investigatory attention.

External triggers such as complaints data and the informal lines of intelligence received from consumer groups will undoubtedly help in identifying those firms who operate on the margins, but without some firm reporting effective FCA supervision will rely wholly on how successfully the FCA and Trading Standards Services (TSS) will be able to collaborate with one another in producing quality intelligence locally. The TSS report that resources are so stretched at local level that unless additional finance can be found, many TSS have little incentive to provide the level of resource for the enforcement of consumer credit they have done hitherto.

It is for these reasons that the FCA should look to fill an enforcement gap by ensuring all lenders - whether higher risk or lower risk with limited permissions – report a minimum level of transactional information (preferably, in real time) such as the number of loans, value of loans, and the numbers of customers who default so that the FCA can build a comprehensive understanding of lending trends and identify firms from across the whole of the credit industry who are not lending responsibly.

Thus far the high cost credit sector has been slow to come to the table to demonstrate how their internal systems and controls are going to shape up, whether to meet the FCA's high level Threshold Conditions, SYSC rules, Money Laundering Regulations or potential requirements for responsible lending. Over the coming months, the high cost credit industry should show an early, genuine commitment to working progressively with the FCA.

- The high cost credit industry needs to demonstrate that it is complying with existing Money Laundering Regulations with compliance monitoring from day one, and will be able to comply with the FCA's high level Principles for Business
- The FCA should fill an enforcement gap by ensuring all high cost lenders - whether higher or lower risk with limited permissions - report a minimum level of transactional information, and preferably in real time
- Given the multiplicity of loans held by individual consumers, there is merit in data sharing for payday lenders
- The FCA should consult on what would be appropriate data reporting for credit firms in its forthcoming SYSC and rulebook consultation papers in the Autumn
- The FCA's investigation into whether payday lenders are inappropriately targeting vulnerable consumers is timely, and the FCA should further clamp down hard on lenders who advertise 'No credit checks'

New s137C of the FSMA and credit caps

By contrast to the FCA's ability to scrutinise the business models of payday lenders, in the run up to the adoption of the Financial Services Bill 2012, there has been considerable debate as to whether the product design of a payday loan should be curtailed by imposing a maximum rate cap, with this new and very specific power having recently been added to the FCA's toolkit. This new power takes the form of statutory provision s137C of the FSMA which, if invoked, could prohibit firms from entering regulated credit agreements with charges (by way of interest or otherwise) that exceed a "specified amount", in effect enabling the FCA to set a credit cap applicable to all lenders or to set lender-specific rate caps in particular situations.

s137C of the FSMA

(1) The power of the FCA to make general rules includes power to make rules prohibiting authorised persons from

(a) entering into a regulated credit agreement that provides for

(i) the payment by the borrower of charges of a specified description, or

(ii) the payment by the borrower over the duration of the agreement of charges that, taken with the charges paid under one or more other agreements which are treated by the rules as being connected with it, exceed, or are capable of exceeding, a specified amount

Different examples of maximum rate caps can already be found in some US states. Florida is usually cited as the key example, where specific payday lending regulations stipulate a number of product conditions, namely: a maximum loan sum of $500; a limit on transaction fees to $10; a ban on rolling over; restriction on loan terms to a maximum of 31 days; and, a cooling-off period of 24 hours between loans. Evidence from Florida also shows that capping the total amount that people can take out in any one period, for example, $500, improves their ability to pay back that loan. Since the regulations were imposed in 2001, even though 6.8 million loans had been authorised in Florida by 2009, it is reported that not a single loan has been extended beyond the contract period.[13]

Bringing new s137C into the FCA regime demonstrates a strong desire to bring about change in the payday lending sector, and while the government has recently concluded that a variable total cost of credit cap is not the way to address consumer detriment - which in the absence of robust scrutiny and data modelling would appear sensible in the short term - once the new credit regime takes effect, and the FCA starts the process of authorisation, what does seems clear is that the FCA should, as a matter of statute, also consider how new s137C of the FSMA might be applied to payday loans.

13 BIS Committee, Debt Management, 14th Report of the Session 2010-12, p16 paras 60-64

The Competition Commission investigation into the payday market is of relevance here since were the Commission to discover over the next 12 months evidence of the market performing inefficiently, or that firms are persistently making super normal profits at consumers' expense, such evidence would wholly reinforce the case for the FCA to impose some form of credit cap under new s137C.

New s137C of the FSMA and rollovers

New s137C of the FSMA can also be applied to other features of a payday loan, namely rollovers. Much of the criticism levelled at payday lenders has been as a result of lenders seemingly encouraging the "rollover" of loans month after month, with each rollover adding fresh charges to a customer's existing debt causing this to quickly spiral out of control. The OFT high cost credit survey found that one in three loans is rolled over or refinanced, accounting for almost 50 per cent of revenues, with customers in this position being largely captive.[14] While in February 2012, StepChange Debt Charity saw one couple who had as many as 36 payday loans between them which would have required repayments totalling almost £7,000 on their next pay day.[15]

Some measures to limit the number of rollovers can be found in industry Codes such as Section 2E:11 of The Finance and Leasing Association Lending Code which limits the number of rollovers to a maximum of 3, and the Consumer Finance Association (CFA) Lending Code for Small Cash Advances (at paragraph 4.6.4) which also limits rollovers to 3. But, as Code provisions these are voluntary undertakings. Whereas by introducing s137C into the FSMA, the government again clearly intended for the FCA to be able to make rules that specifically "prohibit a firm from entering a regulated credit agreement that remains in force after the end of a specified period", whether this would be by imposing a limit on the overall duration of a rolled-over agreement or a limit on the number of rollovers.

Since payday loans are also purportedly designed only for short term emergencies, so too would it be difficult for the FCA to reconcile that a consumer who is unable to meet a high cost contractual repayment should not then be considered, at least in part, to be at risk of financial difficulty. Since a consumer would be at risk of financial difficulty, this would clearly point to the FCA limiting the number of payday rollovers to a maximum of one.

- When a payday loan is rolled over this should be used by lenders as an indication of financial difficulty
- The FCA should invoke new s137C of the FSMA to limit the number of payday rollovers to one, from day one

COB rules, Industry Codes and charge transparency

As highlighted briefly above, when considering how best to assess firms for authorisation, it would not be unreasonable for the FCA to take account of relevant pre-existing requirements found across MCOB rules, Industry Codes or other guidance. Or, in other words, since there is a mutual interdependency between firms' business models and the standards of conduct that are still to be adopted by the FCA for firms, it is only by considering how the two will interrelate to one another will it be possible to establish an appropriate regulatory minimum, while equally remaining alert to how industry best practice can be evolved through Industry Codes. Nowhere, perhaps, is this more apparent than in respect of firms' charging practices.

Take the FCA's MCOB rules on charges, for example. Since mortgage lending has some comparable features to unsecured lending, MCOB rules are an obvious (if not natural) starting point for the FCA as it starts to draft the CCA into its rulebook – more so if the FCA is to achieve a level of consistency across different lending markets.

14 OFT compliance review 2012, page 12
15 StepChange Debt Charity Statistical Yearbook 2012, p27

MCOB 12.4 , which covers arrears charges provides that

MCOB 12.4

(1) A firm must ensure that any regulated mortgage contract that it enters into does not impose, and cannot be used to impose, a charge for arrears on a customer except where that charge is a reasonable estimate of the cost of the additional administration required as a result of the customer being in arrears

While MCOB 12.5 further prohibits firms from imposing excessive charges more generally, MCOB 12.5.3 set out the factors used to determine whether a charge is excessive,

MCOB 12.5.3

When determining whether a charge is excessive, a firm should consider:

(1) the amount of its charges for the services or products in question compared with charges for similar products or services on the market

(2) the degree to which the charges are an abuse of the trust that the customer has placed in the firm

(3) the nature and extent of the disclosure of the charges to the customer

Accepted market theory believes that where charges are easy to understand, this enables consumers to play an active role in the market and exert a downward pressure on market price, thus allowing different market players to compete more effectively. So, MCOB rules acknowledge that whether a fee should be considered as excessive goes hand in hand with how transparent product or service charges are presented to consumers.

With respect to payday loans, depth consumer research undertaken by Consumer Focus in March 2010 found that consumers saw the costs of loans in terms of the actual £ value of the fees, rather than the percentage rate of interest and because they were told the amount they would have to repay for each £100 borrowed, they felt they were not misled about the fees they would have to pay back, if payments were made on exactly the date agreed when they took out the loan. Many also said the charges were easier to understand and presented more clearly than other credit products offered by banks such as credit cards and personal loans, with consumers then seeming to prefer the charges associated with payday loans even though they are unaware of the rates of interest and how this compares to the rates of other mainstream financial products.

For mainstream lenders, however, any past attempts to improve transparency of the total cost of credit have been made using the Lending Code and the UK Cards Association Best Practice Guidelines through the introduction of Summary Boxes, following UK adoption of the 2008 Consumer Credit Directive and its implementing regulations.[18] The Summary Boxes co-exist with the pre-contractual Standard European Consumer Credit Information sheet (SECCI) and set out how the APR, which is calculated by using a prescribed format or Total Charge for Credit (TCC), should be presented in any credit advertising. The Lending Code does not cover overdrafts, albeit a Total Charge for Credit (TCC) is required under the 2008 CCD for overdrafts.

Unlike the previous Consumer Credit Directive, the 2008 Directive is based on full (maximum) harmonisation, meaning that Member States are precluded from adopting or retaining different national law provisions within the harmonised areas, other than to the extent permitted by the Directive. Yet, since the 2008 Directive makes reference only to how the APR is presented, it is nevertheless conceivable that a purposeful interpretation of the 2008 CCD together with FCA high level principle 7 – "A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading" – can allow for total cost of credit to also be presented alongside the APR as a pounds per X number of days format.

16 The provisions of MCOB 12.4 are reflective of the Unfair Terms in Consumer Contracts Regulations 1999, Schedule 2, para 1 (e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation

17 Consumer Focus, Keep the Plates Spinning, March 2010

18 The Consumer Credit (EU Directive) Regulations 2010, SI 2010/1010; The Consumer Credit (Total Charge for Credit) Regulations 2010, SI 2010/1011 amended by: The Consumer Credit (Total Charge for Credit) (Amendment) Regulations 2012, SI 2012/1745

The Competition Commission investigation into the payday market is also likely to shed some further light on how charge transparency can best be achieved across credit markets.

- Over the coming months, the OFT, FCA and industry should work together to develop new formats for the presentation of the total cost of credit, default and other charges, enabling consumers to exert a downward pressure on costs and make the credit market work more effectively. This might include a Code provision but should, in any event, include consideration of a total cost of credit over a set number of days
- The OFT referral of the payday lending sector to the Competition Commission is a welcome development. The Commission investigation will provide valuable insight into how best to achieve transparent competition in a sector that is currently not delivering positive outcomes for consumers

The FCA approach to Continuous Payment Authority

StepChange Debt Charity has previously raised concerns about the misuse of the continuous payment authority (CPA) as a convenient means to recover money at low cost, and because this reduces the need for firms to undertake proper credit checks. As part of its evidence submission to the OFT, StepChange Debt Charity advisers reported clear signs of payday lenders ignoring financial difficulty, using a CPA without any regard to whether the customer was able to pay essential household bills thus placing them into further financial hardship. The problem was often made worse by the failure of high street banks to adequately train their staff on the use of CPA. Specifically that it can be cancelled by contacting the account operator ie. the bank, not only the payday lender.

The FCA has recently secured a commitment from the largest banks and mutuals to review every individual complaint they have received about the non-cancellation of a CPA and to pay redress where payments have continued to be made despite the customer cancelling the arrangement. This will apply to all complaints since November 2009 when the FSA, the FCA's predecessor, began regulating banking conduct. This is a welcome undertaking. However, it would be further helpful if the FCA were to provide a report on firms' practices concerning CPA cancellation, which consumers and debt advisors can compare with their own experiences, in 12 months time.

- The FCA should provide timely reports on firms' practices, particularly those of payday lenders, concerning CPA cancellation in 12 months time

2 Debt management

Business models and excessive charges

Just as there are significant concerns about the business models of payday lenders and where to set the regulatory bar, so too consumers and consumer groups have identified a range of not too dissimilar problems in the debt management sector, especially when considering that when someone requests help with managing their debts they are already likely to be experiencing financial difficulty.

In 2010 StepChange Debt Charity set up its social policy network to gather information about its clients' experiences to inform future policy work and campaigning. The network comprises a team of more than 100 people, located across the 10 different offices throughout the charity, with plans to increase the number of staff and develop the network further.

Evidence from the social policy network, indicates that the conduct and consumer outcomes of debt management companies can be extremely poor. The greatest area of concern has consistently been as a result of excessive charges, followed by misleading advice or advertising – again, often related to the lack of transparency about fees and charges - with the remaining issues ranging from cold calling to making false claims and being similar to those StepChange Debt Charity clients raise in the debt collection sector[19] (see below).

Throughout 2012, StepChange Debt Charity Social Policy team has also started to see rising incidences of unfair practice where debt payments have been retained by a firm, rather than passed on to the lender, and the switching of clients between different parts of essentially the same company, incurring additional fees along the way.

		2013 (to 31st May)	2012	2011
Fee charging debt management companies	1	Excessive charges for services provided	Excessive charges for services provided	Misleading, incorrect or insufficient advice
	2	Misleading or deceptive advice	Misleading or unrealistic advertising	Excessive charges
	3	Criticising or lying about StepChange Debt Charity	Criticising or lying about StepChange Debt Charity	Substandard or unacceptable service
	4	Withholding or not disbursing payments	Misleading or deceptive advice	Unrealistic claims or promises made
	5	Inaccurate or technically wrong advice	Cold calling	Withholding or not disbursing payments

19 StepChange Debt Charity Data Warehouse

StepChange Debt Charity experience tallies with many of the findings of the OFT compliance review in 2010. But, more worryingly, this now seems to point very clearly toward a rise in the number of 'bogus' firms who provide spurious advice to gain the most profit, with some firms charging as much as £2,000 for the completion of a bankruptcy form when this service can be accessed entirely for free.

As for payday lenders, before becoming FCA regulated, debt management providers will need to meet the FCA's more stringent Threshold Conditions and high level Principles for Business, "to demonstrate that a firm's affairs are being conducted in an appropriate manner regarding the interests of consumers and the financial integrity of the UK financial system", including whether their business models and product governance processes are suitable. And, it is in light of these requirements that it is highly questionable whether the business models of some debt management firms can be justified when these rely so heavily on adding yet greater financial burdens on consumers already in financial difficulty, effectively placing them in an even worse financial position than they would have been if they had not employed the services of a debt management provider at all.

In short, how does charging excessive fees for arranging a debt management solution respond to the needs or long term interests of customers in financial difficulty?

Charging excessive fees for providing debt management services seems so clearly counterintuitive to the FCA's operational objectives, that such practices must again surely raise alarm bells about business ethicacy. So, before debt management firms are authorised, just as is the case for payday lenders, it would seem prudent for the FCA to undertake a thematic review of the charging practices of debt management firms. And, furthermore, given the levels of detriment that many consumers can experience today as a result of excessive debt management charges, it would seem prudent to actually stop debt management firms, under new section 138M of the FSMA, from charging more than a maximum charge as a percentage (%) of the money that is available to repay debts.

New s138M of the FSMA and maximum charge cap

New s138M of the FSMA governs the circumstances in which the FCA can impose emergency rules to protect consumers. When making any permanent rules to enhance consumer protection, the FCA under FSMA should normally consult the new Prudential Regulation Authority and thereafter the public, and provide a cost/benefit analysis in respect of the proposed rules. However, an exception to this is found in new s138M, introduced as part of the Financial Services Act 2012, which enables the FCA not to comply with these requirements on the grounds of consumer protection, and create temporary product intervention rules (TPIRs) instead. The Rules are temporary insofar as they are not able to remain in existence beyond 12 months from the date when they came into force, during which time the FCA must decide whether or not to implement permanent product intervention rules, with public consultation on the permanent rule(s) ensuing as a result.

Although it is understood that the FCA has already started to engage with the debt management industry in respect of new capitalisation requirements, since the FCA has little to no experience of the debt management sector, it is unlikely it will be able to develop a firm understanding of debt management business models and charging practices until long after April 2014; with firms receiving interim permissions in the meantime. So, unless the FCA were to impose a TPIR charge cap, this would leave consumers open to a significant risk of harm during the transition period to the new regime, with the levels of detriment that can be experienced when engaging a debt management provider today being allowed to sneak under the regulatory bar and take root within the FCA regime, despite there being a TPIR fail-safe mechanism precisely designed for use in circumstances that are uncertain.

Imposing a TPIR charge cap as a percentage (%) of the money that is available to repay debts on debt management firms is likely to be interpreted by some as too blunt a response, yet for a regulator that is serious about its commitment to resetting conduct standards across consumer facing markets, if there is one area where it seems very clear that the FCA should intervene and take robust preventative action, it is the excessive charges of debt management firms.

As a brief aside, expressing charges as a percentage (%) of the money that is available also has the advantage of helping to bring, in the short term, a greater degree of charge transparency to the debt management sector. Unlike other parts of the consumer credit market where consumers must be provided with certain pre-contractual information right upfront, consumers who buy debt management solutions often have very little idea of the amounts that they will be charged and it is often not possible to compare prices or shop around for a better deal. Once again, there is a read across here to the MCOB provisions on excessive charges, particularly MCOB 12.5.3 when determining whether a charge is excessive, with firms having to consider (1) the amount of its charges for the services or products in question compared with charges for similar products or services in the market; and (2) the degree to which the charges are an abuse of trust that the customer has placed in the firm.

- The FCA should undertake a thematic review of the charging practices of fee charging debt management firms before they are fully authorised
- Working with consumer and debt advice groups, the FCA should impose a Temporary Product Intervention Rule (TIPR) under new s138M to cap the charges of debt management firms as a percentage (%) of the money that is available to repay debts
- Working with consumer and debt advice groups, the FCA should give consideration to how it can improve charge transparency for consumers across the debt management sector
- As in the payday lending sector, debt management firms should be prioritised for authorisation by the FCA

COB rules and OFT Debt Management Guidance

Over the coming months, there will be substantial debate about the precise nature of the FCA COB rulebook and whether it can fully accommodate OFT Guidance, the biggest area of contention being the depth of prescription required if the FCA is to make clear to firms that it will not tolerate specific bad behaviours.

The OFT's Debt Management Guidance, for example, has been developed over many years, and more recently updated to prohibit specific practices that have grown out of technological innovations; namely, cold calling using persistent SMS or text messaging, lead generation websites[20] and client switching.[21] Lead generation websites have been singled out as a particularly acute problem owing to these being set up by firms solely as a means to capture prospective client data, only to then pass on this data to another firm, and charging the consumer in the process 'for the privilege'. And, it is because of this rapid change and technological inflection, enabling firms to target consumers very quickly, that the case for tackling bad behaviours as COB rules, is especially strong.[22] However, since the Guidance sets out using comprehensive lists what it considers as bad behaviour, what this also means is that, if the FCA rulebook is to accommodate OFT Guidance,

20 OFT Debt Management Guidance, from page 21, paras 3.1- 3.9

21 ibid, page 53, para 3.34 (j)

22 In the past, when implementing the Unfair Commercial Practices Directive (UCPD), the FSA has also said that it did not see the need for additional rules in its Handbook "because it already contains principles and rules that have the same effect as the UCPD", confirming the interplay that exists between FCA rules and the requirements of the UCPD, and as also referenced throughout the OFT Debt Management and Debt Collection Guidance

then FCA COB rules too will need to be reasonably specific; albeit, it may be possible to capture some of the balance of regulation under the FCA's high level Principles.

Take the MCOB rules on financial promotions. MCOB 3.7 (and PERG 8)[23], provides for the definition of real time and non-real time unsolicited financial promotions, which must be fair clear and not misleading, with additional rules for prescribing their form and the prominence of content. MCOB 3.7.3 further specifically prohibits a real time financial promotion unless it refers to the firm in general terms and does not convey product or costs related information.

By contrast, OFT Guidance draws extensively on the provisions of the Commercial Practices Regulations (CPRs)[24] alongside the Privacy and Electronic Communications Regulations (PECR)[25], and in doing so lists all the activities it would see as being harmful – such as lead generation, direct marketing and personal visits – while also setting these in context of what would be considered as indicative of an unfair business practice that may be completely prohibited.

Para 3.9 (a) of the OFT Guidance on debt management states that,

a. any advice, website content or other advertising (including pay-per-click) provided/produced by that third party is clear and transparent about the nature of the service being provided and does not breach the Consumer Protection from Unfair Trading Regulations 2008

Para 3.12 Examples of unfair or improper business practices with regards to lead generation and direct marketing include:

a. lead generators falsely claiming to, or implying that, they offer debt management services
b. not making the true nature of the service to be provided sufficiently clear to consumers via website or other advertising content or when using other direct marketing contact methods such as, for example, telephone calls or text messaging
c. failing to be sufficiently clear as to what the consumer's details (personal data) will be used for
d. failing to declare the existence of a financial interest in a lead or referral, including 'pay-per-click
e. failing to declare, on request by the consumer, the nature of any relevant association, or prior arrangement, with the third party providing the service being offered, such as a debt management business
f. falsely claiming or implying contact is being made on behalf of the government or charities and/or making any other false or misleading claims or statements regarding 'status'.

Similarly, where consumers are deliberately targeted and switched by firms to another debt solution, with the consumer being charged unjustifiable duplicate or additional fees, the OFT Guidance makes specific provision for this as an unfair practice under Para 3.34(j).

So, where firms are

"operating a policy of charging additional fees where a consumer is switched to a different debt management option and where the decision to switch is not based on a material change in the consumer's circumstances or in the stance of creditors"

such behaviour may constitute a breach of OFT Guidance, and, presumably, is prohibited.

Since many of the problems being experienced by consumers identified through the StepChange Debt Charity Social Policy Network are already covered by the OFT's Debt Management Guidance, so it would be reasonable to expect these behaviours to be tackled as a priority by their first being transposed into the FCA rulebook, and thereafter, rigorously enforced by the FCA from day one.

23 FCA Perimeter Guidance for financial promotions an related activities
24 The Consumer Protection from Unfair Trading Regulations 2008
25 Privacy and Electronic Communications Regulations 2003

- The problems identified across debt management through the StepChange Debt Charity Social Policy Network should be tackled by the FCA by its drafting of COB rules
- COB rules will need to be reasonably specific, albeit it may be possible to capture some of the balance of regulation (eg. relating to data reporting) under the FCA's high level Principles and SYSC. Detailed comment on the draft rules will be provided by StepChange Debt Charity once the FCA publishes its consultation document in the Autumn
- The FCA should clamp down hard on misleading advertising and the other bad practices identified in the debt management sector by consumer groups from day one

3 Debt Collection

COB forebearance and debt escalation cap

Unlike the payday and debt management sectors, the problems experienced by consumers across debt collection have less to do with firms' business models, but still relates to where the FCA should set the regulatory bar, namely how to treat customers in financial difficulty fairly. There is again an obvious read across to the approach taken by the FCA to regulate mortgages.

Under current COB rules for mortgages, FCA regulated firms are required to show consumers in financial difficulty a degree of 'forebearance' ie. that reasonable efforts have been made to assist them in repaying their mortgage when there has been a sudden change in their circumstances. MCOB 13, for example, states that,

MCOB 13.3.2A

(1) A firm must make reasonable efforts to reach an agreement with a customer over the method for repaying any shortfall ….

(2) Liaise, if the customer makes arrangement for this, with a third party source of advice regarding the payment shortfall or sale shortfall

(3) Allow a reasonable time over which the payment shortfall or sale shortfall should be repaid having particular regard to the need to establish, where feasible, a payment plan which is practical in terms of the circumstances of the customer ….

(6) Not repossess the property unless all other reasonable attempts to resolve the position have failed

It is these COB requirements for reasonableness which speak to how any firm providing services to those in financial difficulty should behave. So, it is already implicit under the FCA regime that firms be required to demonstrate how forebearance translates into their own activities, since their working on a sustainable basis in the interests of consumers is a prerequisite for treating customers fairly.

The Lending Code provisions reaffirm this approach for credit lenders. Paragraph 224 of the Lending Code directs lenders to consider reducing or stopping interest and charges when a customer evidences that they are in financial difficulties and 'stops' or freezes a debt from increasing altogether where a customer is only able to make only token payments.

It is debateable, however, whether the MCOB and Lending Code provisions on forebearance should stop here, since arguably the MCOB requirements for forbearance raise questions of debt escalation more generally; and especially at a time when consumers are feeling financially pressured, access to credit is being made easier and many consumers are increasingly at risk of falling into debt traps owing to a rising multiplicity of debt. It follows then that the FCA should consider whether to use its rule making powers to provide those who fall into financial difficulty with a greater degree of financial certainty, and capping the costs of debt so that debt levels and charges do not then spiral out of control.

Arguably, this would be a course of action readily available to the FCA, again by using its new rule making powers under new s137C of the FSMA, where, as seen above, the FCA has the power to "*prohibit authorised persons from entering into a regulated credit agreement that provides for the payment by the borrower of charges of a specified description,"* so enabling the FCA to cap any and/or all of the different charges of a credit lender.

Invariably, there will be questions of where exactly this cap should be placed, yet there is a body of good practice in the not-for-profit debt advice sector which would serve as a useful starting point. StepChange Debt Charity Budget Guidelines and the Common Financial Statement (CFS)[26], for example, set out *trigger figures* designed to identify reasonable levels of monthly expenditure across different household and other items when accepting an offer of repayment, and thus the extent or *threshold* at which a consumer will start to experience financial difficulty. These, alongside other financial statements, capture client data about individual levels of income and the different types of debt held, which, if aggregated could be used to construct data modelling and ascertain the multiples of debt individual consumers are actually experiencing. StepChange Debt Charity has already started do this as part of its ongoing policy work, tracking prevailing debt trends or *debt cocktails*, and mapping these against income and expenditure levels and different firm charging practices.

Industry early intervention

It is worth noting that in seeking to regulate debt collection, 'trigger figures' or indicators used by the not-for-profit debt advice sector, could arguably be drafted into FCA COB rules to formally operationalise the provision of debt advice. Arguably, this would encourage consistency in the preparation of offers made by debt advisors/debtors since trigger figures or indicators are generally accepted by creditors enabling repayment offers to be dealt with more quickly under a streamlined process. However, prescriptively drafting 'trigger figures' into rules would most likely be too rigid an approach for firms, especially if there were a 'debt escalation cap'. Firms will, in any event, need to be able to demonstrate under the FCA's high level threshold conditions and SYSC rules, that they are able to adapt and be flexible to achieve good outcomes for all different types of consumer. Having said this, it would be helpful to know why the FCA considers COB rules for advised sales to be important for the sale of mortgages but not for the sale of debt solutions.

This approach would also enable the FCA to consider separately and jointly with the Money Advice Service (MAS), how best to achieve consistent debt advice across debt collection, working with consumer groups and the not-for-profit debt advice sector (for which the MAS provides some funding through a statutory levy on creditors). The not-for-profit money and debt advice sector has a symbiotic relationship with lenders, given the support they provide to people either in financial difficulty or who have more general money related matters, such as advising on a court summons, liaising with utility providers and securing welfare benefits. In other words, since there is a mutual interdependency between the services provided by the not-for-profit money and debt advice sector and credit lenders, the two sectors necessarily work 'in step' with one another.

As part of the MAS Quality Framework those not-for-profit organisations that are to receive funding through MAS will have to demonstrate that they meet certain quality assurance standards, covering 3 main areas:

(i) meeting clients' needs

(ii) well governed and

(iii) a learning organisation

26 The Common Financial Statement is a standard and consistent way for money advisers to communicate with creditors. It is jointly sponsored by the British Bankers' Association (BBA) Money Advice Trust (MAT) and the Finance and Leasing Association (FLA)

This is as well as showing a commitment to developing the organisation and continuously improving on the "quality of advice and delivery across the sector".[27] The MAS will also expect debt advisers to be appropriately qualified. So it is possible that because MAS accredited organisations will have to demonstrate how they will learn from their client base, presumably developing processes for greater *early intervention,* that over time, this learning will also have a strong domino effect, working its way into the debt collection processes of lenders and other firms. This is especially so when considering that for regulated firms, FCA SYSC requirements must also be met by the collection of management information or the identification of client 'feedback loops' as a means to encourage ongoing service improvements and ensure customers' are treated fairly.

This convergence of responsibilities between FCA and MAS around debt collection and not-for-profit money and debt advice is ripe for developing further good practice and better processes for *early intervention* with client data about individual levels of income and different types of debt, again being modelled to pin point when consumers find themselves most at risk and start to fall into financial difficulty.

- The FCA should impose COB rules to freeze interest, default fees and other charges where consumers can demonstrate they are experiencing financial difficulty
- The FCA should work with consumer groups to undertake data modelling of the types of debt actually being experienced by consumers, and introduce a debt escalation cap to stop debts from spiralling out of control, by mid-2015
- A debt escalation cap should seek to prevent severe detriment and build from existing good practice such as Budget Guidelines, the Common Financial Statement and other debt advice tools used by the not-for-profit debt advice sector
- It would be helpful to know why the FCA considers rules for advised sales to be important for the sale of mortgages but not for the sale of debt solutions
- The FCA should establish an 'early intervention' working group of representatives drawn from across consumer groups, the not-for-profit debt advice sector and industry firms to report back within 9 months before firms are fully authorised

COB rules and OFT Debt Collection Guidance

Across the Debt collection sector[28], StepChange Debt Charity also sees a range of bad behaviours where there is a case for these to be tackled through COB rules. When a consumer misses a repayment or defaults, they are not necessarily presumed to be in financial difficulty, but they will nevertheless, feel far more uncertain about how they should be treated given that they have missed a repayment, with this anxiety making it easier for debt collectors to present themselves as having more powers than they actually do. This is also despite the numerous self-regulatory or industry codes provisions that currently exist but where both membership and enforcement can be patchy.

As shown in the table overleaf, over the last couple of years there has again been a rising incidence of firms using aggressive, threatening and intimidating behaviours with clients, including cases of misrepresenting themselves as bailiffs.

Making COB rules is therefore important as rather than the emphasis being on firms having legal certainty, in the debt collection sector the emphasis should be more on consumers being given legal certainty since it is they who are very likely to be physically confronted and/or persistently intimidated, especially where they have fallen into debt and the debt has been passed to a third party for collection.

27 Achieving consistent and high quality debt advice, CP December 2012. Assurance area – a learning organisation – section 3 (3.2), p 17

28 The debt collection sector comprises 3 main categories of firm (i) firms pursuing the recovery of their own debts arising from credit loans (ii) firms pursuing the recovery of their own debts arising from hire purchase agreements and, (iii) firms pursuing the recovery of debts, whether credit loans or hire purchase, of others, whose activities are triggered by missed payment or the account falling into arrears

		2013 (to 31st May)	2012	2011
Debt collectors	1	Misrepresenting legal powers	Misrepresenting legal powers	Breach of lending code or OFT 664
	2	Misleading or deceptive advice	Excessive interest or charges added to debt	Lying or misleading the client
	3	Statutory demand used inappropriately	Misleading, threatening or inaccurate correspondence	Misleading, threatening or inaccurate correspondence
	4	Posing as bailiffs	Posing as bailiffs	Excessive interest
	5	Data protection breach	Excessive phone calls or calling at inappropriate times	Refusing to consider reasonable offer

Here again the OFT's Debt Collection Guidance provides extensive lists of behaviours it considers as bad, but which owing to the distinctive nature of debt collection business can also veer into criminality, and so are not necessarily well reflected anywhere within the FCA rulebook. These include behaviours such as false representation of authority or physical and psychological harassment.

Para 3.7, for example, refers to:

a. contacting debtors at unreasonable times and or at unreasonable intervals

b. pressurising debtors to raise funds by selling their property or by taking on further borrowing (including extending their existing borrowing)

c. multiple businesses seeking to recover the same debt at the same time, resulting in repetitive and or/frequent contact with the debtor (or his representatives) by different parties

d. threatening to refer the debt to a third party debt collection business, with potential cost implications for the debtor …

i. pressurising debtors to pay more than they can reasonably afford without experiencing undue difficulty or to pay within a reasonably short period, for example, by using the threat of enforcement action through the courts

As the above list of examples helps to show, at its simplest and basic level, all debt collection firms should be communicating with their customers in a non-threatening, professional manner rather than assuming that missed repayments mean that consumers are unwilling to pay and are therefore 'open season'. As a result, a quick and relatively easy response would be if the FCA were to undertake a product governance and literature review of the communications used by the debt collection sector, establishing a project oversight team to identify examples of best practice. The BBA Lending Code and other Code provisions might offer a useful starting point. Industry Codes contain a number of key provisions aimed, for example, at establishing proper processes and systems for helping people who may be experiencing mental stress, including "allowing the customer a reasonable amount of time to collect and submit evidence" and "sensitively managing communications with the customer (for example preventing unnecessary and unwelcome mailings)",[29] having recognised that the impacts of financial difficulty can be especially acute for people who have or are experiencing mental health issues.

Since the debt collection sector is a broad church comprising disparate and often very small firms, the FCA will also first need to carry out a thorough risk assessment of firms so that appropriate funding can

29 See The BBA Lending Code, paragraphs 173 - 183

be made available for certain aspects of work to be undertaken by local Trading Standards Services (TSS). TSS funding is undoubtedly a contentious issue, but unless the FCA and TSS are able to work together collaboratively, developing appropriate data systems along the way, persistent difficulties in the debt collection sector are unlikely to be satisfactorily resolved, not least because many of the problems raised are highly localised.

- The problems identified across the debt collection sectors through the StepChange Debt Charity Social Policy Network should be tackled by the FCA by its drafting of COB rules
- Again, COB rules will need to be reasonably specific. StepChange Debt Charity will provide further comment on these once the FCA publishes its consultation document in the Autumn
- At its simplest and basic level, all debt collection firms should be communicating with their customers in a non-threatening, professional manner, taking into account a customer's mental health. The FCA should quickly undertake a product governance and literature review of customer communications
- Since debt collection agencies are a broad church comprising disparate and often very small firms, funding could also be made available for certain aspects of work to be undertaken by employing local Trading Standards Services

Conclusions

In practical terms FCA resources are currently under strain, with necessary emphasis being placed on the authorisation of firms and drafting of its conduct rulebook. But, the FCA should not wait until long after it has assumed its full responsibility for consumer credit before starting to clean up the credit market, especially the payday, debt management and debt collection sectors where the scope for consumer detriment is greatest. Many of the problems that have been identified are not new, yet it is only by tackling them now, and before the FCA completely finalises its rulebook, that the FCA will be able to properly reset firm standards, establish a regulatory bar, and finally start delivering on a new settlement for consumers of consumer credit.

There are a key number of areas where FCA initiatives can be rolled out early. These are designed to assist the FCA to quickly bring its knowledge and understanding of a varied and disparate credit market up the curve. More importantly, they will help prepare the credit industry for a wholly different way of being regulated well in advance of the FCA taking on its new responsibilities. While this places scrutiny of business models and regulatory reporting at the forefront of all lender firm activity, demonstrating that firms are treating their customers fairly, the FCA should also work robustly through its new rule making and product intervention powers to impose a maximum charge cap on debt management firms and a 'debt escalation cap' when collecting debts, to stop consumers' debts spiralling out of control.

Finally, it seems clear that the FCA COB rulebook will need to be both relatively prescriptive and comprehensive if it is to tackle all of the problems currently experienced by consumers across the debt management and debt collection sectors. Consumers need sufficient rulebook transparency if they are to understand the standards of behaviour they can expect from firms when dealing with credit and credit related services. A lack of transparency, on the other hand, whether by firms or by the FCA, will mean that consumers will be unable to help themselves or to play a strong, pro-active role in making credit and credit related markets compete more effectively in the future.

Annex 1 – Roadmap to the FCA – Establishing a regulatory minimum

	Problem	Response				
		Threshold Conditions	**FSMA power**	**COB Rule**	**Industry code or other guidance**	**TCF and SYSC**
Payday Lending	Excessive charges	Assessment that business plan is suitable	s137c and s138m (see ** below)			
	Targeting vulnerable consumers			See financial promotions' rules		
	Roll overs		s138m FCA should limit roll overs to 1		Move to s137c rule	
	Lack of charge transparency			See MCOB 12 rules for excessive charges	Work with industry on transparency of charges Lending Code for eg. has summary boxes	
	Consumer over-optimism				Provide health warnings as do for mortgages if don't keep up repayments	
	Irresponsible lending			CCA and impose rule that firms must assess creditworthiness		Regulatory reporting under SYSC and ML Regs
	Cold calling/text messages			Impose rule		
Log book loan companies	No credit checks	FCA says no business plan req'd				Limited permissions firms should report transaction data into FCA (ie go beyond SYSC 7.1.2A)
	Aggressive practices re: car seizure			Impose rule		
Debt Management	Excessive charges	Assess if business plan is suitable, including audit of client accounts	** s137M – FCA impose new rule for a maximum charge cap	CCA 2006 – statement of arrears and charges. TCF and MCOB 12.4 – 13.5	Work with industry on transparency of charges	Firms should report transaction data under SYSC
	Not passing on payments				See OFT Debt Management Guidance, para 3.43 (a). Move to COB rules	

	Problem	Response				
		Threshold Conditions	**FSMA power**	**COB Rule**	**Industry code or other guidance**	**TCF and SYSC**
	Misleading or unrealistic advertising esp. fees	FCA to assess the industry norm		See financial promotions rules	Currently in OFT Debt Management Guidance para 3.30, 3.32 and 3.34 (a) to (o). Move to COB rules	
	Misleading information about StepChange			Impose rule		
	Misleading or deceptive advice					Track under SYSC
	Lead generation	Firms should be regulated				
Debt Collection	Excessive default and other charges		FCA s137C – FCA impose new rule to stop ‘debt spirals’	CCA 2006 – statement of arrears and charges See TCF and MCOB 12.4 – 12.5.3 and 13.3.2A on forebearance		
	Time Orders			Provide an important protection and need to stay		
	Mis-use of continuous payment authority			See MCOB 13.3.2A		
	Lack of charge transparency			See MCOB 12		
	Mis-representing legal powers	Local collaboration with TSS and review of client communications		Impose rule	See OFT Debt Collection Guidance, esp. paras 3.4 and 3.5	
	Threatening correspondence			Impose rule		
	Harassment via phone calls			Impose rule		
	Aggressive doorstep collection			Impose rule		
	Masquerading as a bailiff			Impose rule		

Annex 2 – Roadmap to the FCA – Early FCA initiatives

	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015
	Apr-June	**July-Sept**	**Oct-Dec**	**Jan-Mar**	**Apr-June**	**July-Sept**	**Oct-Dec**	**Jan-Mar**
Mortgage arrears and forebearance (thematic review)	Engage with selected lenders	Firm assessment visits MMR Data reporting CP 13/2 deadline 15.08.13	Report thematic findings		MMR changes take effect – 26.04.13			
FCA approach to credit regulation and rulebook		FCA credit draft rules and SYSC CP to be published		Rules are made	New credit regime takes effect			
Payday lenders			FCA and OFT Industry and engagement	Industry to work to put in place transaction reporting from day 1	Firms to report data	Firms to report data Competition Commission to report	FCA to prioritise scrutiny of business models for full authorisation	Interim permissions to end early
All lenders			FCA and OFT Industry and engagement Industry to commit to transaction reporting from day 1	Industry to work to put in place transaction reporting from day 1	Firms to report data	Firms to report data Competition Commission to report	FCA to start 12 month initiative on transparency of total cost of credit, default fees and other charges	
Firms with limited permissions			FCA industry engagement Industry to commit to transaction reporting from day 1	Industry to work to put in place transaction reporting from day 1	Firms to report data	Firms to report data	….	….

	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015
	Apr-June	**July-Sept**	**Oct-Dec**	**Jan-Mar**	**Apr-June**	**July-Sept**	**Oct-Dec**	**Jan-Mar**
FCA approach to credit regulation and rulebook		FCA credit draft rules and SYSC CP to be published		Rules are made	New credit regime takes effect		FCA approach to credit regulation and rulebook	
Debt management			FCA industry engagement FCA to start 9 month thematic review of charging practices of debt management providers, including charge transparency	Industry to work to put in place SYSC for debt managers (adequate capitalisation) from day 1	Firms to report data Introduce Temporary Product Intervention Rule (TPIR) for excessive charges	Firms to report data	Thematic review to report	
Debt Collection (FCA)			FCA to start 9 month thematic review on arrears handling FCA to work with consumer/ debt advice groups on data modelling to stop 'debt spirals' FCA/MAS/ consumer/debt advice groups to work on 'early intervention'	FCA industry engagement	Firms to report data	Firms to report data	Thematic review to report	Start full authorisation
Debt Collection (FCA/TSS)				FCA to start 9 month thematic review of systems and client communications				Thematic review to report. Full authorisation to start thereafter

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