

## The key points

The Government announced in January 2012 that it would transfer responsibility for regulating consumer credit from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA) by 1 April 2014, providing it could be satisfied that a proportionate regime could be designed. The Government has now published a Consultation Paper setting out their proposals.

We have published a Consultation Paper setting out high level proposals on how we will regulate consumer credit. Summaries of each chapter are provided here. Although this is a summary, we encourage you to read the chapter which you have more interest in and which impacts on your firm and respond.

From April 2013, the FCA will be responsible for conduct regulation. Its vision is to ensure consumers get a fair deal. Underpinning this are three broad outcomes:

- consumers get financial services and products that meet their needs, from firms they can trust;
- markets and financial systems are sound, stable and resilient, with transparent pricing information; and
- firms compete effectively, with the interests of their customers and the integrity of the market at the heart of how they run their business.

This underpins our approach to the design of the consumer credit regime and our proposals share many of the features of our approach to other regulated markets. Where there are differences, this reflects the need to deliver a regime that is proportionate for the different segments of this market and appropriate to the risks.

### Chapter two: proposed new framework

The Government set two objectives for the new regime:

- strengthening consumer protection; and
- a proportionate regime for firms; only placing requirements on firms where there is a clear benefit for consumers.

Our regime will aim to strengthen consumer protection in the following ways:

- increased flexibility through rule-making powers;
- more resource than the OFT;
- dealing with problems earlier;
- better standards in the industry e.g. by scrutinising firms more closely before they are allowed to carry on consumer credit activities; and
- improved access to redress.

The proportionate features of our proposals are:

- reduced requirements for firms carrying out certain lower-risk activities;
- a transitional period to help OFT licensees prepare for aspects of the new regime;
- limited reporting requirements;
- requirement to hold specified minimum levels of capital applies only to debt management firms;
- no compensation scheme cover; and
- tailored requirements for pre-approval of individuals in firms.

### ***Lower-risk activities***

These activities still pose risks to consumers, but we consider them to be lower than the risks of other consumer credit activities. They are:

- consumer credit lending by sellers of goods and non-financial services where there is no interest or charges;
- consumer hire;
- credit broking as a secondary activity by sellers of goods and non-financial services (except where this is carried on in the home on more than an occasional basis); and
- not-for-profit bodies carrying on debt advice, alongside debt adjusting and credit information services.

We expect that our overall approach will not be changed in the medium term, but we will keep the regime under review and develop it where we see new risks emerging.

## **Chapter three: interim permission regime**

The Government proposes that OFT-licensed firms who want to carry on their consumer credit activities after April 2014 will be able to do so, providing they notify us and pay a fee. We expect firms to be able to notify us in good time before April 2014. We propose charging a one-off fee (see fees chapter summary).

These firms will be referred to as having an ‘interim permission’ or if we already regulate them, an ‘interim variation of permission’. It will generally only cover the activities for which they are currently licensed.

Existing OFT licences will lapse on 31 March 2014 and interim permissions will begin from 1 April 2014. If a firm has not received an interim permission, they will not be able to carry on regulated consumer credit activities, unless they are an exempt person.

The information required for the interim permission is limited. It will include:

- up-to-date and accurate information of the firm’s contact details and controllers as recorded by the OFT; and
- a list of consumer credit activities the firm is currently licenced to undertake.

We also propose to ask firms to provide, on a voluntary basis, some limited information to help supervise them (e.g. turnover, complaints information, number of agents).

The interim permission will last until either:

- a firm cancels their interim permission;
- we approve or refuse an application for authorisation; or
- if a firm does not apply for authorisation by a date we set, their interim permission will expire.

## Chapter four: authorisations

The Government has proposed that the interim regime (covered in chapter three) will end by 1 April 2016, except for credit firms who applied by the date set by the FCA and are still to hear a decision on an outstanding application. All firms with an interim permission that wish to carry on regulated consumer credit activities will need to be authorised by the FCA.

Firms with interim permission will have to apply for full authorisation, or full variation of permission, by the date set by the FCA, if they want to carry on regulated consumer credit activities after that date. Different dates may be set for different descriptions of activities and our current thinking is that the earliest date will be in the fourth quarter of 2014. Firms new to the credit industry from 1 April 2014 onwards will need to apply for full authorisation.

Firms must demonstrate, at the time of authorisation that they meet, and will continue to meet, our minimum standards known as ‘Threshold Conditions’.

The Government proposes that firms carrying on only the lower-risk activities described in Chapter 2 (see summary above) have lesser authorisations requirements.

We want to ensure regulated firms are well-run, recognise the risks they face and have:

- appropriate strategies, systems and controls in place. A big part of this involves firms; and
- having the right people in important roles in firms. We propose vetting individuals who perform key functions known as ‘controlled functions’ to ensure they are up to the job, and once they are in their role they are carrying it out effectively.

## Chapter five: alternatives to authorisation

There may be alternative options for firms to becoming directly authorised by us. They are:

- being an appointed representative of an authorised firm;
- being a self-employed agent of a home-collected credit firm; or
- being an exempt professional firm.

## Chapter six: prudential standards for debt management firms

Prudential standards are requirements about the type and amount of financial resources a firm must set aside for regulatory purposes. They take a number of forms, such as a specified minimum level of capital that the firm must hold. They are important because they aim to minimise the risk of harm to consumers by ensuring firms behave prudently in monitoring and managing business and financial risks and hold suitable financial resources.

We are proposing that debt managers are subject to a requirement to hold a minimum amount of capital. This means debt managers would need to ensure they have a reserve of money to protect their business and their customers if they make a loss. We normally use turnover as the measure for setting capital requirements, but are considering if other options may be more appropriate for debt management firms, including:

- a percentage of the size of debt contracts being negotiated;
- a percentage of the amount of client money held; or
- a combination of the above.

## Chapter seven: conduct standards

We are proposing a framework of rules and guidance setting out the high-level standards for how firms should behave, and more detailed rules and guidance about how firms should conduct themselves with their customers:

- **The Principles for Businesses:** establish the principles for behaviour that we require from firms, applicable to all their consumer credit activities.
- **Other high-level standards:** setting standards for how firms should organise and manage their affairs, including the Senior Management Arrangements and Systems and Controls.
- **Conduct standards:** setting detailed standards for how firms should conduct themselves with their customers. These will be based on the current conduct standards set out in the CCA and OFT guidance. Guidance will be strengthened and given the status of rules where appropriate.

We are consulting on the draft rules to bring into force the Principles for Businesses and other high-level standards. We intend to consult on the detailed conduct rules and guidance in autumn 2013.

We are also considering whether to include certain provisions of industry codes in our rules.

## Chapter eight: conduct standards for specific activities

There are proposals for conduct standards of specific activities:

- **Providing debt advice including not-for-profit debt advice bodies**  
We propose to apply different rules to different types of advice, reflecting the different nature of the advice and associated risk.
- **Firms holding client assets**  
Client assets are money or property held by a firm on behalf of a customer. We consider debt management businesses to be the firms in the credit sector that pose the greatest risk to consumers from holding client money. In the autumn, we will consult on additional rules requiring debt management firms holding client money above a certain amount to take additional precautions around how they hold and monitor it.
- **Peer-to-peer lending platforms**  
The Government is proposing that the activity of ‘operating an electronic system in relation to lending’ by peer-to-peer lending platforms should be a regulated credit activity. We consider that consumers borrowing or lending via peer-to-peer platforms should be provided with enhanced protections and intend to consult on draft rules in autumn 2013.
- **Firms which outsource tracing of debtors to tracing agents**  
The Government is proposing that a third party to whom the activity of tracing borrowers is outsourced by the lender or a debt collector should be an exempt person, so long as the third party takes no other steps to collect debts. We hold authorised firms responsible for activities they choose to outsource.

## Chapter nine: supervision and reporting

How the FCA will supervise consumer credit will be different from the OFT. Our approach to supervision will be consistent with the approach for all other firms we regulate.

All firms will be categorised into one of two groups, according to the impact they could have on our objectives. They are ‘fixed’ portfolio and ‘flexible’ portfolio.

We are still finalising the method we will use to categorise consumer credit firms. However, it is likely to include factors such as the size of the firm, the number of retail customers and the perceived risk to consumers due to the firm’s activities. We expect that firms with a large number of customers, for example retail banks, will be categorised as a fixed portfolio, meaning they will have a dedicated supervisor.

Smaller firms will be categorised to a flexible portfolio, which means they will be supervised by a team of sector specialists. We expect a significant amount of consumer credit firms to fall into this category.

There are three areas to our supervision approach, and its intensity varies once again depending on the firm's impact on our objectives. The three areas are:

- firm systematic framework – looking at what is happening and where there could be a problem.
- event-driven work – quickly responding to an issue and fixing what has gone wrong, working to remedy the issue in the firm.
- issue and product supervision – work to stop a problem emerging within a firm or sector.

We propose that firms are required to report certain data to us, to help us focus our resources on the sectors and issues that are of greatest significance to reduce the risk posed to customers. The type of information we expect to collect includes turnover, transactions, complaints and the number of customers. We propose that firms such as debt managers and lenders will be required to provide more data.

## Chapter ten: enforcement

Enforcement is a way to deter firms and individuals from poor practices, while taking swift, strong action against those that cause the most harm. Our powers under FSMA are significantly greater than the OFT's powers under the CCA.

We will have a wide range of enforcement tools available, including withdrawal of authorisation, stopping individuals working in financial services, public censure and imposing financial penalties. We will also have investigatory rules such as applying for warrants to enter and search premises.

We can use our enforcement powers in the following areas:

- breaches of FCA rules;
- firms/individuals who are suspected of carrying out consumer credit activities without the required permission (known as unauthorised business);
- breaches of remaining conduct provisions of the CCA;
- offences committed under CCA (some of the criminal offences set out in the CCA will continue to apply after April 2014); and
- breaches of the money laundering regulations.

We will work alongside Local Authority Trading Standards Services and the Department for Enterprise and Trade in Northern Ireland, among other bodies, to uncover and stop unauthorised business, such as loan sharking. We will also seek to ensure that where a firm has committed wrongdoing, consumers are adequately compensated.

We will be able to use our powers to look at behaviour before 1 April 2014, and apply the sanctions that were in force at the time.

## Chapter eleven: complaints and redress

We propose to retain the right for consumers to complain to the Financial Ombudsman Services (FOS) if they are unhappy with the way that their complaint has been handled by a firm. The transfer of consumer credit to us will make no difference to the standards that firms should meet in their complaints handling.

We propose new requirements that firms (not already authorised by us) carrying on consumer credit activities should record, report and where appropriate publish complaints information to us.

We propose that all micro-enterprises should be eligible to complain to the FOS about consumer credit.

We do not propose to extend Financial Services Compensation Scheme cover to consumer credit activities, but we will keep this under review.

## Chapter twelve: preventing financial crime

Stopping firms being used to facilitate financial crime is one of our priorities. Regardless of the size of a firm, there are various ways it can be affected by financial crime. We propose to require all firms to actively take measures to prevent themselves and their customers from being exploited by criminals.

We are not just interested in how a firm protects itself, but also where its action exposes customers or a third party to the risk of financial crime.

Some examples of types of financial crime risk we can look at are:

- how businesses protect themselves and their customers from losing money to fraudsters;
- many, but not all, consumer credit businesses are subject to the Money Laundering Regulations 2007. We will take action against non-compliance; and
- the measures consumer credit firms take to ensure sensitive customer data does not fall into the wrong hands.

We can take action where a firm has weak systems and controls in place to prevent financial crime, even if no crime has taken place.

We also propose requiring firms subject to the Money Laundering Regulations 2007 to take further measures, including appointing a Money Laundering Reporting Officer (MLRO).

## Chapter thirteen: fees

The FCA will be entirely funded by the firms it regulates. We aim to cover our costs in a way that is as fair and efficient as possible.

We recover our costs through:

- fees that we charge to firms that apply to be authorised to carry on regulated activities; and
- annual fees that we charge authorised firms to cover the costs of supervising them.

Each firm is allocated to a fee block, which is defined by the regulated activities the firm carries out. This means that firms carrying out similar activities will be charged the same.

We will consult on authorisation and annual fees for consumer credit providers in the consultation paper on FCA fees that we are planning to publish in October/November 2013.

In addition to authorisation and periodic fees, we propose charging a one-off fee for OFT licensees who require an interim permission, to cover our costs of administering the process.

We propose a one-off fee of:

- sole traders £150; and
- other firms £350.

We do not propose to collect a general FOS levy from firms with an interim permission to carry out consumer credit activities until they apply for FCA authorisation.

## Chapter fourteen – next steps

Please send us your comments by **1 May 2013**. We will review all your responses and publish our feedback on them. This will include our final rules/guidance for the two areas where we have consulted on draft rules and guidance in this paper: the high-level requirements to come into effect on 1 April 2014; and our fees for interim permissions.

We will publish another Consultation Paper in the autumn, which will ask for your comments on the details of our proposed regime for consumer credit, including the conduct standards that will apply from 1 April 2014.