

Consumer credit

LEARNING OBJECTIVES

This short topic focuses on the rules surrounding the provision of consumer credit. 'Consumer credit' includes personal loans, hire purchase, credit cards and store cards. It has only been regulated by the FCA since 2014, but it is an area of financial services that has been subject to legal requirements since 1974.

By the end of this topic, you should have an understanding of:

- the provisions of the Consumer Credit Acts;
- the changes resulting from the Consumer Credit Directive;
- activities subject to full FCA authorisation; and
- the provisions of the Consumer Credit sourcebook (CONC).

This topic covers part of the Unit 2 syllabus learning outcome K2.1.



THINK ...

Even if you have no other experience of FCA regulation, it's likely that you have encountered the rules that apply to the provision of consumer credit: many of us have a personal loan, overdraft, hire-purchase arrangement, credit card or store card.

If you have any of these products, have a look at your credit agreement before you start studying this topic.

- What issues are covered by the agreement?
- How clearly is the key information, such as how much you have to pay, presented?

Keep the agreement by you as you are studying, so that you can look at how the legislation and regulations are applied in practice.

Another area of consumer credit regulation that you might have seen reports about in the media involves payday lenders.

- Do you know what these are and why some of their activities were considered to be a problem?

22.1 What are the Consumer Credit Acts?

The Consumer Credit Act 2006 covers the regulation of certain loans to individuals, small partnerships and unincorporated bodies (but not companies) – referred to as ‘consumer credit’. The Act sets out standards by which lenders must conduct their business. It builds on the Consumer Credit Act 1974, with the objective of increasing protection and meeting the needs of the modern marketplace, while retaining many of the basic provisions of the 1974 Act.

Regulatory powers for consumer credit activities and firms involved in consumer credit were transferred to the FCA in April 2014. The regulations for firms are contained in the CONC sourcebook, which incorporates and builds on the Consumer Credit Acts.

CONC contains FCA rules regarding the marketing, selling, disclosure, customer information, debt handling and administration of consumer credit, together with basic principles relating to firms’ conduct and the fair treatment of customers.

Regulated mortgages, including all loans secured on an individual’s main residence, are specifically exempt from the provisions of the Consumer Credit Act and are regulated under the Mortgages and Home Finance: Conduct of Business rules (MCOB).

22.1.1 Main provisions

The main provisions of the Consumer Credit Act 2006 and those retained from the 1974 Act are as follows:

- There is generally no limit to the amount of a loan covered by the Act.
- Loans over £25,000 to a small business for business purposes are exempt from the regulations.
- High-net-worth borrowers can opt to be exempt from the Act, but it must be at their request rather than the lender’s requirement.
- Borrowers protected by the Act include an ‘ordinary’ borrower or a partnership with three or fewer members. Although sole traders and unincorporated associations are covered under the Act, other businesses are outside the legislation.
- Complaints relating to credit arrangements regulated through the Act can be taken to the Financial Ombudsman Service (FOS).
- There are provisions to increase the fair treatment of borrowers.

- Borrowers must be given a copy of the credit agreement in writing.
- Borrowers are given a cooling-off period of 14 days from the latter of the contract starting or receipt of a copy of the agreement to change their mind. If the borrower exercises this option, they must repay any money received and any interest accrued to that point. The contract for goods linked to the borrowing is not cancelled, so the borrower must find another way to pay for them.
- The lender must send the cooling-off notice with a copy of the credit agreement.
- Certain agreements do not benefit from the right to cancel using the cooling-off period. Examples include bank overdrafts, small loans of £50 or less (unless they are hire purchase or conditional sale agreements), small loans of £35 or less completed away from the lender's premises and loans to pay death duties.
- The annual percentage rate (APR) for the loan must be calculated using a set formula, which includes all relevant costs of setting up the loan. The APR must be shown in any advertisements or agreements.

THE IMPORTANCE OF APR

One of the 1974 Act's most significant innovations was a system for comparing the price of lending. This is the APR, which must be quoted for all regulated loans. The APR represents a measure of the total cost of borrowing and its aim is to allow a fair comparison, between different lenders, of the overall cost of borrowing.

The calculation of the APR is specified under the terms of the Consumer Credit Act 1974 and it takes account of two main factors:

- the interest rate – whether it is charged on a daily, monthly or annual basis; and
- the additional costs and fees charged when arranging the loan, such as an application fee.

The result is that the APR is higher than the interest rate being charged on the loan.



ANNUAL PERCENTAGE RATE OF CHARGE (APRC)

Under the provisions of the EU Mortgage Credit Directive, a new annual percentage rate of charge (APRC) was introduced from 21 March 2016. The APRC is similar to the APR and applies to first- and second-charge mortgage lending. APR applies to personal loans, credit cards and hire purchase agreements.

22.1.2 The Consumer Credit Directive

The Consumer Credit Directive (CCD) was implemented by six sets of regulations (some of which have since been repealed as part of the changes in the regulation of consumer credit). The implementing regulations apply to all consumer credit agreements regulated under the Consumer Credit Acts (CCAs), other than agreements secured on land, although there are modifications for certain types of agreement.

The key changes brought about by the EU Credit Directive are as follows:

- A representative example must be included as part of any advertisement that shows an interest rate or a figure relating to the cost of credit. This example must include a 'representative' APR.
- Creditors must assess a borrower's creditworthiness before granting credit or significantly increasing the amount of credit.
- 'Adequate explanations' must be provided in respect of a proposed credit agreement, to enable the borrower to assess whether the agreement meets their needs.
- Certain information must be provided to a borrower before they enter into a credit agreement, and there are standards for the way in which that information must be provided. Pre-contractual information must be given in good time before the borrower enters into the agreement, and the information must be clear and easily legible.
- The borrower has the right to withdraw from a credit agreement within a period of 14 days (the cooling-off period) from the conclusion of the agreement, or from the point the borrower receives the agreement, if this is later.
- The borrower must be notified, in writing, of changes to the interest rate under the agreement, before the change takes effect.
- The borrower is able to seek redress from the creditor in certain circumstances if they are unable to obtain satisfaction from the supplier of the goods or services. This applies in cases where the CCAs would not

normally provide for such redress, and where the value of goods or services is more than £30,000 and the credit does not exceed £60,260.

- The borrower can terminate an open-ended agreement at any time, subject to giving one month's notice. The creditor must give two months' notice of termination of credit and must give justified reasons for termination.
- The borrower must be informed if the debt is to be sold to a third party.
- Credit intermediaries must disclose the extent to which they are acting independently or work exclusively with one or more creditors. Any fee payable to the intermediary must be disclosed up front.
- Where an application for credit is declined based on information supplied by a credit reference agency, the creditor must notify the borrower and provide contact details of the credit reference agency.



IMPORTANT

The second EU Consumer Credit Directive (CCD) has now come into effect. The new directive provides enhanced protection for European consumers who apply for credit, and it repeals and replaces the first CCD. It does not apply to the UK, as it was introduced in October 2023. However, the UK government is expected to consult on reforming the Consumer Credit Acts, which govern the UK's consumer credit regime. We advise you to stay informed about any developments in this area.

KEY TERMS

REPRESENTATIVE APR

An APR that applies to 51 per cent or more of successful applicants for the credit product.

CREDIT INTERMEDIARY

Helps an individual to obtain credit, eg by helping them to complete a loan application, or find the lender offering the best rates or willing to lend to those with a poor credit history.

22.2 FCA consumer credit regulation and authorisation

The FCA has applied certain aspects of its regulatory approach to consumer credit. While the general scope of CCA provisions remains unchanged, some aspects of the FCA's approach are more rigorous.

- Consumer credit firms must be authorised by the FCA.
- The FCA maintains a register of firms that have been granted a consumer credit licence.
- FCA conduct rules apply, such as the high-level Principles for Businesses – for example, financial promotions must be clear, fair and not misleading.
- The FCA expects firms that offer consumer credit to comply with the Consumer Duty and to demonstrate how they ensure the fair treatment of their customers.
- The FCA has greater supervisory powers than the OFT had. The FCA uses its senior managers and certification regime for individuals performing roles that require FCA approval or certification.
- The FCA also has much greater powers than the OFT had with regard to investigation, enforcement and redress. It has dedicated supervision and enforcement teams to tackle poor practice in the industry.

HIGH-COST, SHORT-TERM CREDIT

One area on which the FCA has focused is the high-cost, short-term lending market, such as 'payday' lenders. Such lenders provide loans on what is intended to be a very short-term basis: for example to cover a shortfall in funds between one payday and the next. Prior to the FCA's intervention, interest rates on these types of loan were very high; borrowers who were unable to repay the loan in full at the original due date and had to 'roll over' the loan for an extended period found themselves having to repay far more than they had originally borrowed.

Following a review of this sector of the market, the FCA introduced a cap on high-cost, short-term credit. Interest and fees charged must not exceed 0.8 per cent per day of the amount borrowed, default fees cannot exceed £15, and borrowers must never be required to repay more than 100 per cent of the amount borrowed by way of fees and charges.



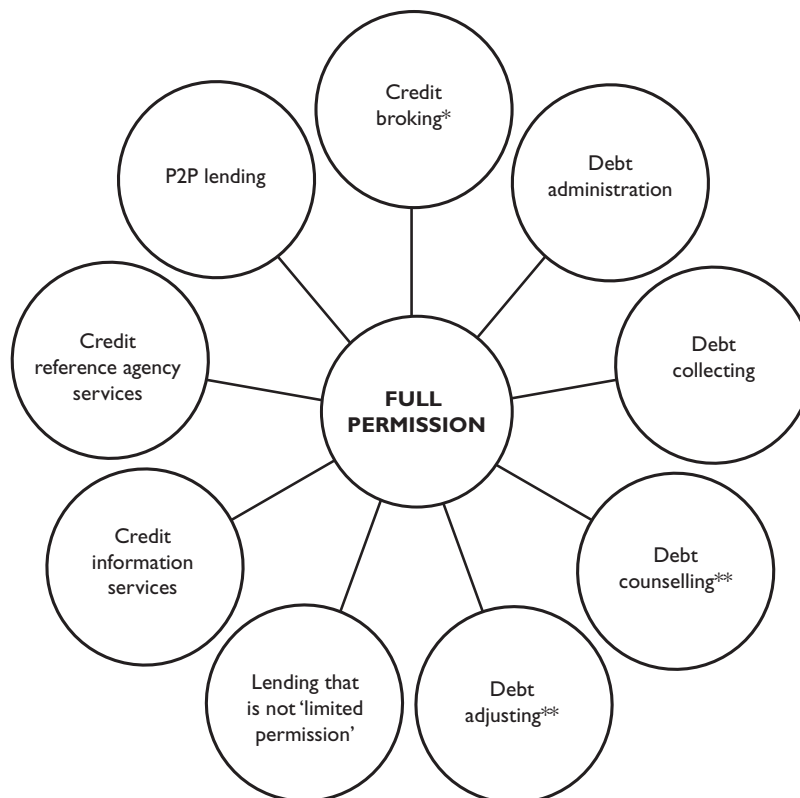
CHECK YOUR UNDERSTANDING I

Can you recall the FCA's objectives from your studies in Topic 17? Which of its objectives does the restriction on high-cost, short-term lending best demonstrate?

22.2.1 FCA authorisation

The FCA's authorisation structure for consumer credit activities comprises full and limited permission tiers. Most activities covered by the full permission regime are summarised in Figure 22.1.

FIGURE 22.1 ACTIVITIES REQUIRING FULL PERMISSION FROM FCA



*Where introducing customers to a lender is the main business activity or where the sale of goods or services takes place in the customer's home (a domestic premises supplier).

**Where carried out on a commercial basis.

The limited permission tier covers 'lower-risk' activities. It is aimed at businesses outside financial services that are caught by the consumer credit legislation and regulations. Firms carrying out lower-risk activities cannot apply for full FCA authorisation and are required to supply less information to the FCA in comparison with firms that require full authorisation.

FACTFIND

If you wish to find out more details about businesses within the limited permission tier, check:

www.fca.org.uk/firms/authorisation/consumer-credit-lenders-hirers

22.2.2 Consumer Credit sourcebook (CONC)

The FCA has not made substantial changes to the provisions of the CCAs, which continue to provide the main framework for UK consumer credit regulation. The relevant details are contained within the Consumer Credit sourcebook (CONC), which was introduced in April 2014. A summary of the provisions of CONC is provided here.

CONC 1: Application and purpose and guidance on financial difficulties

Explains the purpose of CONC as a specialist sourcebook for credit-related regulated activities, and reminds firms that the Principles for Businesses apply. There is also guidance on the FCA's indicators that a customer is in financial difficulty.

CONC 2: Conduct of business standards – general

In respect of their credit-related activities, all providers are expected to treat customers fairly and not mislead them. Examples of activities that may contravene these rules are:

- targeting customers with offers of credit that are unsuitable for them;
- high-pressure selling, aggressive or oppressive behaviour or coercion;
- not allowing sufficient and reasonable time to make repayments;
- taking steps to repossess a customer's home other than as a last resort.

CONC 3: Financial promotions and communications with customers

Much of the earlier legislation relating to the provision of quotations and advertisements was repealed and included in this section of CONC.

This section details what is considered to be a 'communication' with a customer in relation to a credit agreement, and advises that communications should be fair and not misleading. Providers must ensure they use plain and understandable language, specify who is making the offer of credit and only

make credit available based upon the consumer's financial circumstances. A firm must be a permitted approver to approve financial promotions, unless an approver permission exemption applies.

CONC also introduces new rules relating to risk warnings for high-cost, short-term credit, such as that offered by payday lenders. Any such lending must carry the message: "Warning: Late repayment can cause you serious money problems. For help, go to moneyhelper.org" (FCA, 2021).

CONC 4: Pre-contractual requirements

Deals with the content of quotations for credit and the relevant 'health warnings' that must be included. This is particularly significant when the customer's home is to be used as security. In such circumstances the lender must include the statement: "Your home is at risk if you do not keep up repayments on a mortgage or other loan secured on it" (FCA, 2014).

CONC 4 also details the information a lender must provide about interest rates, charges and costs should the borrower be unable to pay.

CONC 5: Responsible lending

Details what a provider must do before making credit available in order to ensure that the customer can afford to maintain payments in respect of their borrowing. Creditworthiness must be confirmed based on information obtained from the prospective borrower and from a credit reference agency. The rationale behind this explicit requirement is that there was concern that some lenders of short-term funds (such as payday lenders) were not undertaking adequate checks.

CONC 5A: Cost cap for high-cost, short-term credit

Details the maximum charges that can be applied for high-cost, short-term credit (such as that provided by payday lenders). Broadly speaking, the payment of any charge, when combined with other charges applied under the terms of the agreement, cannot exceed an amount more than that borrowed.

CONC 5B: Cost cap for rent-to-own agreements

This imposes a total credit cap of 100 per cent on rent-to-own agreements, meaning firms cannot charge more than the cost of the product. Firms must also benchmark their base prices (including delivery and installation) against the prices charged by three mainstream retailers on the high street.

CONC 5C: Overdraft pricing

This requires firms to implement and maintain overdraft charging structures that are simple, transparent and capable of easy comparison. It forbids firms from obliging a customer to pay a rate of interest for an unarranged overdraft that exceeds the rate of interest for an arranged overdraft.

CONC 5D: Overdraft repeat use

Firms must monitor customers' patterns of overdraft use, identify patterns of repeat use and take appropriate steps with the aim of changing such patterns of use.

CONC 6: Post-contractual requirements

Covers the checks a lender must undertake if they significantly increase the lending to a customer under a regulated agreement, eg increasing an overdraft or the credit limit on a credit card. Creditworthiness must be assessed if there is a significant increase in lending.

This section also details the action a lender must take if a customer exceeds their overdraft limit, which is to contact the customer in writing without delay.

CONC 7: Arrears, default and recovery (including reposessions)

CONC 7 states that providers must have appropriate policies and procedures for dealing with customers whose accounts fall into arrears, and must treat such customers fairly and reasonably. This includes being aware of customers who are considered vulnerable, for example, customers with mental health difficulties.

Another aspect of this regulation is that it covers debt collection and debt administration activities, and the organisations that undertake such work. This area of consumer credit was previously unregulated.

CONC 8: Debt advice

Debt advice can be undertaken by third-party debt counsellors and other organisations that provide information. Failure to pay proper regard to the different debt-solution options available to consumers, or to the differences in enforcement actions and procedures available, is likely to contravene the Principles for Businesses (including the Consumer Duty). Examples include recommending a debt solution that is unaffordable to the consumer, or discouraging a consumer from seeking an alternative source of debt counselling.

CONC 9 used to set out requirements for credit rating agencies but has now been deleted.

CONC 10: Prudential rules for debt management firms

Details the rules for debt management firms (those that manage repayments to creditors on the behalf of an individual) and small, not-for-profit debt advice bodies to ensure that the relevant financial and management resources are in place.

CONC 11: Cancellation

Covers the cancellation rights of peer-to-peer lenders and those providers that make services available over the internet.

CONC 12–15 and Appendix 1

Deal with some of the less common areas of consumer credit. Appendix 1 contains the rules relating to the total charge for credit, what it applies to and how it is calculated.

**CHECK YOUR UNDERSTANDING 2**

Firms providing consumer credit are required to adhere to the FCA's Principles for Businesses. Can you remember what they are? See if you can list them and then look back to section 17.6 to check your answer.

**THINK AGAIN ...**

Now that you have completed this topic, can you:

- describe the main provisions of the Consumer Credit Act 2006?
- describe the changes that resulted from the Consumer Credit Directive?
- identify the activities that require full FCA permission?
- outline the provisions of the Consumer Credit sourcebook (CONC)?

Write notes to help you revise the key points.

Test your knowledge before moving on to the next topic.

References

FCA (2014) *CONC 4.1 Content of quotations* [online]. Available at: www.handbook.fca.org.uk/handbook/CONC/4/1.html

FCA (2021) *CONC 3.4 Risk warning for high-cost short-term credit* [online]. Available at: www.handbook.fca.org.uk/handbook/CONC/3/4.html




Test your knowledge

Use these questions to assess your learning for Topic 22. Review the text if necessary.

Answers can be found at the end of this book.

- 1) Which of the following is exempt from the Consumer Credit Acts?
 - a) A credit card account with a limit of £5,000.
 - b) A further advance for house repairs of £15,000.
 - c) A loan for £20,000 secured on property for car purchase.
 - d) An unsecured personal loan of £10,000.
- 2) How does providing an APR in relation to consumer credit help consumers?
- 3) Businesses are not protected by the provisions of the Consumer Credit Acts. True or false?
- 4) How long is the cooling-off period for a customer once they have signed a consumer credit agreement?
- 5) If a lender rejects an application on the basis of information from a credit reference agency, what must the lender do?
 - a) Ensure the applicant is not made aware of the reason for the rejection to protect the confidential nature of the lender's relationship with the credit reference agency.
 - b) Only advise the applicant of the reason for rejecting their application.
 - c) Advise the applicant of the reason for rejecting their application and provide details of the credit reference agency used.
 - d) Advise the applicant of the reason for rejecting their application and provide details of a debt counselling service.
- 6) A charity that provides debt counselling services must have full permission from the FCA. True or false?
- 7) What is the maximum that a borrower can be required to repay to a high-cost, short-term lender in fees and charges?

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- 8) Interest rates provided in an advertisement for consumer credit must include what?
 - 9) Providers of consumer credit must check that the applicant can afford the repayments and must check the applicant's status with a credit reference agency. True or false?
 - 10) Which previously unregulated area of consumer credit now falls under the provisions of CONC 7?

