Solicitors Regulation Authority

SRA - Designated Professional Body

Consultation: Regulation of consumer credit activities

October 2014

SRA's regulation of consumer credit activities

Consultation - regulation of consumer credit activities and SRA's role and obligations as a Designated Professional Body

1. The SRA is an independent regulator of legal services providers in England and Wales. This consultation has been published in order to seek the views of our stakeholders, including those we regulate, consumers and their representatives.

Summary of our proposal

2. This consultation seeks views on our proposal to withdraw from the Financial Conduct Authority's (FCA) Designated Professional Body (DPB) regime for the purposes of consumer credit activities. This means that SRA-authorised firms carrying on any regulated credit activities would need to apply to the FCA for authorisation rather than being able to rely on the Part 20 exemption set out in the Financial Services and Markets Act 2000 (FSMA).

3. The SRA has considered this matter in discussion with a range of organisations. We recognise the need for wider, informed discussion and are therefore, setting out the position as we understand it and seeking views through formal consultation.

Background

4. The Financial Services and Markets Act 2000 (FSMA) replaced the provisions of the Consumer Credit Act 1974 (CCA 1974) which covered licensing and other aspects of the regulatory framework for consumer credit regulation. Therefore, consumer credit activities that were licensable under the CCA 1974 became regulated activities under FSMA. Regulation of consumer credit activities transferred from the Office of Fair Trading (OFT) to the FCA on 1 April 2014. Consumer credit activities are part of normal business practice for many financial institutions and firms, and may also form part of the work of law firms. As a consequence of the transfer of regulation, the SRA is now required to have in place new regulatory arrangements governing how SRA-authorised firms carry on consumer credit activities. These arrangements need to meet the approval of the FCA.

5. The FCA's model of regulation is designed for financial services, including consumer credit activities. The SRA's approach to regulation is designed for the legal services market where the issues and risks are different. This approach is increasingly focused on developing and delivering regulation that is proportionate to the nature of an entity, the services it provides and the associated risks and has generally led to the removal of detailed and prescriptive rules. By contrast, the FCA's arrangements for consumer credit impose detailed obligations on those it regulates. It is difficult to see how two such different approaches can be reconciled to provide coherent and consistent arrangements.

6. Consumer credit activities are part of the normal practice of a wide range of financial and other businesses, those providing legal and other professional services.

7. A consumer credit agreement is an agreement between an individual and any other person by which the creditor provides the debtor with credit of any amount. This definition is capable of capturing a number of financial arrangements and normal business practices which are relevant to regulated firms. Certain types of credit agreement are exempt or excluded from legislation, but it is important to note that the term "consumer credit agreement" covers far more than merely credit card or hire-purchase arrangements.

8. The FCA's new consumer credit regime applies to the following activities (as well as other activities not listed) all of which may be conducted by SRA authorised firms:

    - **Credit broking** - where a client is referred to a lender for a loan that is to be a credit agreement or referred for a hire purchase loan;

    - Debt related consumer credit activities, which include:

        - **debt adjusting** - negotiating terms with creditors on behalf of a client for settlement of the debt due under a specific regulated credit or consumer hire agreement;
        - **debt counselling** - providing advice to a client about the liquidation of a debt due under a specific regulated credit or consumer hire agreement; and
        - **debt collecting** - steps associated with the collecting of debts due to others, when the debts are due under a regulated credit or consumer hire agreement.

    - **Entering into a regulated credit agreement as lender** - agreeing with an individual client that professional fees are paid by instalments ; and,

    - **Providing credit information services** - on behalf of a client seeking to amend information held by a credit information agency about his/her financial standing or to prevent that agency holding or disclosing such information.

9. As noted above, responsibility for the regulation of consumer credit activities transferred from the OFT to the FCA on 1 April 2014. FSMA replaced the provisions of the CCA 1974 which covered licensing and other aspects of the regulatory framework for consumer credit regulation. As a result, consumer credit activities that were licensable under the CCA 1974 are now regulated activities under FSMA.

10. Up until 1 April 2014, SRA-authorised firms and individuals were permitted to carry on consumer credit activities under an OFT group consumer credit licence which was held by the Law Society (managed by the SRA). The group licensing regime enabled firms to operate without having an individual licence, provided that they were overseen by their professional body and had regard to OFT

guidance. The regime was as set out in the CCA 1974 and secondary legislation, as well as in guidance published by the OFT.

11. The SRA was responsible for ensuring the competence and integrity of any of the group members - i.e. SRA-authorised firms and individuals - that carried on licensable consumer credit activities under the cover of the group licence. Where issues arose with potential implications for a firm's consumer credit activity, the SRA would refer a regulated person to the OFT so that they could make an assessment and consider varying the group licence to exclude a member from the group as set out in sections 28 and 31 of the CCA 1974. These referral arrangements meant that the SRA did not need to build extensive consumer credit capability, but instead relied heavily on the expertise of the OFT.

12. SRA-authorised firms could undertake consumer credit activities set out in the group licence. These activities included consumer credit, credit brokerage, debt adjusting and debt counselling, debt collecting, debt administration and provision of credit information services. The way in which firms carried on this work was governed by their duties as members of the profession, including their obligations to their clients, to third parties and to the administration of justice as set out in the SRA Handbook and other regulatory provisions.

13. From 1 April 2014 onwards, firms carrying on regulated consumer credit activities must meet one of four criteria:

    - be authorised by the FCA with the appropriate permission;
    - have been granted interim permission by the FCA;
    - be exempt under the SRA's arrangements made under Part 20 of FSMA; or
    - have ceased carrying on consumer credit activities.

14. Under Part 20 of FSMA, the carrying on of FSMA regulated activities by members of a DPB, such as the SRA[1], is exempt from the general prohibition and SRA-authorised firms carrying on such activities under the Part 20 regime do not have to be authorised by the FCA. These firms are referred to as exempt professional firms (EPFs). As a DPB, the SRA is required to have rules that govern the carrying on of consumer credit activities by these exempted firms.

15. Transitional provisions within the SRA's Financial Services (Scope) Rules 2001 came into effect on 1 April 2014 allowing firms to rely on the Part 20 exemption until 1 April 2015.

The FCA's approach to the regulation of consumer credit

16. The FCA's regulatory framework focuses on increasing protection for people obtaining credit by ensuring they can trust the entities providing the credit; ensuring that each product meets the individual's needs and that aggressive and misleading practices are not adopted in activities such as debt collection.

[1] By virtue of being the independent regulatory body of the Law Society of England and Wales

As part of fundamental changes to the consumer credit regime, firms carrying on consumer credit activities will have to demonstrate the delivery of good outcomes for their customers through compliance with prescriptive rules and under more intensive regulatory scrutiny.

17. The FCA has set out the conduct of business standards that will apply to consumer credit firms. These standards form part of FCA's Consumer Credit Sourcebook (CONC), which in turn is part of the FCA's Handbook

    The FCA's approach to regulation of consumer credit activities is reflected in its rules and guidance which greatly enhances the consumer credit framework that existed under the OFT regime.

18. Many of the provisions contained in the CCA 1974, secondary legislation made under that Act and guidance published by the OFT have been carried across by the FCA into their own rules and guidance. The intention being that these regulatory provisions will help to protect consumers but reduce the burden for firms moving to the FCA's regulatory regime.

19. The FCA in their business plan for 2014-2015 has set out in detail its approach to regulating consumer credit activities. As part of their information for firms, the FCA have also set out the credit activities which fall within the scope of their regulation.

Authorisation by the FCA

20. The FCA has confirmed that authorisation (rather than Interim Permission) will be required by all firms engaged in consumer credit activity by 1 April 2016. However, specific categories of firms may be set earlier deadlines by the FCA. This will depend on the credit activities which are carried out and the risk category they fall in.

21. To qualify for FCA authorisation, a firm must be able to meet the requirements of the threshold conditions which include:

    - Location of offices – for UK incorporated firms, the mind and management of the firm must be in the UK;
    - Effective supervision – the firm must be capable of being effectively supervised by the FCA, including the complexity of its regulated activities, products and how the business is organised;
    - Appropriate resources – the firm must demonstrate appropriate financial resources, nature and scale of the business and skills and experience of those managing the firm's affairs;
    - Suitability – the firm must demonstrate the competence and ability of management, and that the firm's affairs are conducted in an appropriate manner regarding the interests of consumers and the integrity of the UK financial system; and
    - Business model – the firm's strategy for doing business must be suitable for its regulated activities.

22. The FCA has proposed a two-tiered, risk-based approach to authorisation of consumer credit firms, whereby the specific requirements necessary to meet the threshold conditions will vary depending on the risk posed to the consumer. It is likely that firms carrying out 'higher-risk activities' will be subject to the more onerous requirements necessary to meet the FCA's threshold conditions. In contrast, those firms only carrying out 'lower-risk activities' will be able to apply for limited permission and will only have to meet modified, lighter requirements to comply with the threshold conditions.

23. The FCA has produced guidance for firms - 'Decision Tool - Helping you determine whether your firm needs full or limited permission'. Firms who may be considering authorisation by the FCA will need consider the guidance which has been issued which sets out what it means to be regulated by the FCA and also the information about fees.

The SRA's view and understanding of Part 20 of FSMA

24. Part 20 has two key provisions relevant to SRA-authorised firms: FSMA regulated activities may be carried on by a member of a DPB who is not authorised by the FCA where the regulated activity "...*arises out of, or is complementary to, the provision of a particular professional service to a particular client...*" (s332(4) of FSMA) and the regulated activity "...*must be incidental to the provision by him of professional services*..." (s327(4) of FSMA). In their respective consultations in 2013, the Financial Services Authority (FSA), the FCA and HM Treasury focused on the second point which concerns the way that the services are provided overall by the firm - the less demanding aspect of the test therefore, easier for most SRA authorised firms to satisfy. However, the requirement in s332(4) necessitates an assessment of the services provided on a case by case basis rather than by the firm overall. In the SRA's view this is a problem.

25. It is clear that at first sight the Part 20 regime appears to provide similar benefits to that of the group licensing regime but in practice it is much more difficult to satisfy the requirements of Part 20 than it was to meet the requirements of the group licence. The group licence allowed SRA-authorised firms to carry on the consumer credit activities listed on the licence provided that the activities were carried on in the course of practice. Consequently, it was possible for a firm to carry on a consumer credit activity in isolation for a client; it was not necessary to show that the particular consumer credit activity was linked to any other activity carried on for that client.

26. In contrast, to fall within the Part 20 regime, any regulated consumer credit activity must arise out of or be complementary to other professional services provided to that particular client[2]. This means that it is no longer possible for an SRA authorised firm to carry on a consumer credit activity in isolation for a client. Whilst this may be an appropriate restriction for other types of regulated activities, it does not meet the needs of clients in relation to consumer credit activities as in the case of, for example, debt collecting or debt counselling, there

[2] Section 332(4) of the Financial Services and Markets Act 2000

may often be circumstances where the only services that the firm is providing to the client are services that involve regulated consumer credit activities.

27. We have discussed this with the FCA and are satisfied that it agrees that, under the Part 20 regime, SRA-authorised firms may only carry on regulated consumer credit activities where they "arise out of, or are complementary to" other professional services provided to that particular client. On this basis it is not possible simply to look at the way that these services are provided by the firm overall.

28. The FCA was asked to provide guidance on the Part 20 exemption so that SRA-authorised firms were sufficiently informed and able to make the appropriate decisions about whether or not they needed to apply for interim permission. The FCA's final rules and policy statement were published on 28 February 2014 and did not include any further guidance relating to Part 20. It is clearly undesirable for firms to be exposed to the risk of potentially committing a criminal offence and some firms may decide to be authorised by the FCA on a precautionary basis to avoid this risk.

Debt collecting and the contentious business exclusion

29. It seems reasonably clear that firms which specialise in, for example, debt collecting as their main activity will not be able to satisfy the "incidental manner" condition in Part 20 and will need to be authorised by the FCA.

30. The more difficult area is where debt collecting does not form a major part of the firm's income. There are exclusions in relation to various consumer credit activities including debt collecting, where the regulated activity is carried on by a solicitor (within the meaning of the Solicitors Act 1974) acting in the course of contentious business (as defined in section 87(1) of that Act).

31. We understand that these exclusions will only be available where proceedings have been issued. These exclusions, however, do not cover pre-issue work. In our view, firms that carry on debt collecting activities for clients in matters that do not result in the issue of proceedings will be carrying on regulated activities and will only be able to rely on the Part 20 exemption where the activities arise out of or are complementary to other professional services provided to that particular client. It may not always be possible to satisfy this requirement.

32. The exclusions referred to above were added to the FSMA (Regulated Activities) (Amendment) (No 2) Order 2013 at a very late stage and did not appear in the draft of the Order that was consulted upon. Consequently, the SRA and others did not have the opportunity to consider and comment on the impact of the wording of these exclusions before the Order was made. Although there was a similar exemption under the CCA 1974, this was in the context of the group licence and any pre-issue work would have been covered by the group licence so would not need to be covered by the exemption.

33. We have made representations to HM Treasury and the FCA concerning these exclusions and have expressed the view that the exclusions should be extended

to exclude activities that take place during the pre-issue work so that they would be available to firms irrespective of whether proceedings are commenced. In our view, the extension of these exclusions would bring a large number of firms that carry on debt collecting work outside FCA regulation. This does not, however, mean that these activities would be unregulated as we would continue to regulate these activities when carried on by firms in the same way that we regulate other activities and continue to ensure that consumers are adequately protected. This approach would avoid the need for dual regulation but without any reduction in consumer protection.

34. It is important to note that not all debt collecting will involve a regulated consumer credit activity, it is only where the debt collecting relates to a consumer credit agreement or a relevant article 36H agreement as defined by the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

Regulating as a DPB

35. The FCA has asked the SRA to amend its Handbook in a way would have the effect of incorporating the FCA's CONC, or substantial parts of it, into SRA rules. But, this appears to be incompatible with our own model of regulation and would mean that the SRA would be responsible for the supervision and enforcement of a regulatory regime over which it has no control.

36. We understand the uncertainty that the transfer of the regulation of consumer credit from the OFT to the FCA is having on SRA-authorised firms while the long term approach is resolved. We have been striving to ensure that any changes to our rules in relation to the carrying on of consumer credit activities are proportionate and wherever possible avoid unnecessary duplication of existing requirements. We, however, believe that this cannot be achieved if we are required by the FCA to incorporate CONC, or substantial parts of it, into our rules.

37. To allow EPFs to continue to benefit from Part 20 in relation to consumer credit activities, the SRA must amend its rules. The SRA Financial Services (Scope) Rules 2001 (Scope Rules) have already been amended to make it clear that during the transitional period from 1 April 2014 to 1 April 2015, EPFs must comply with the provisions and guidance set out in Rule 1.3R of the transitional provisions in CONC as they were in force immediately before 1 April 2014 in relation to that activity. This means that, during the transitional period, EPFs are not required to comply with anything more than they were required to comply with before 1 April 2014 but a breach of such provisions or guidance would now amount to a breach of the Scope Rules. In these circumstances, the SRA would be responsible for the supervision and enforcement of those rules.

38. The issue is what will happen at the end of the transitional period. It is important that consumers receive consistent protection in relation to consumer credit activities, regardless of the nature of the organisation providing services. This means that there is an expectation that DPBs provide "equivalent protection" to consumers, in relation to consumer credit activities, through their rules to that provided by the FCA's rules.

39. The FCA's model of regulation is appropriate for financial services, including consumer credit activities. Our approach to regulation is designed for the legal services market and the risks and issues we are trying to manage are different. The SRA's approach to regulation has developed and we are removing prescriptive and poorly targeted rules. It is clear therefore, that the two regulatory approaches are different.

40. To satisfy the FCA that we can regulate consumer credit activities in the way that is required means replicating the FCA's model at the SRA, with the associated development of staff resources, operational methodology and guidance for both the regulated community and consumers. Consideration must be given to maintaining and calibrating the model in such a way that it is consistent with the broader FCA model to ensure that risk is managed effectively and that consumers receive the same levels of protection from the different organisations.

41. Such a step is likely to be challenging, potentially expensive and a distraction from our core statutory purpose. Because we do not have established consumer credit expertise or capacity, effective regulation would require the recruitment and training of staff to build consumer credit competency. This is likely to take a considerable amount of time and could have disproportionate cost implications for firms and therefore consumers. It is likely to be a distraction from our core function as a legal services regulator.

Impact of our proposal

42. To ensure that consumers have the benefit of experienced and expert protection when they engage with the consumer credit market, **we propose that the Part 20 regime should <u>not</u> be available to firms in relation to consumer credit activities.** The implication of this proposal is that those firms wishing to carry on regulated consumer credit activities would be required to seek authorisation from the FCA.

43. According to our records, around 1100 SRA-authorised firms – around 10% of the total - are involved in debt collection work but it is likely that many other firms are also involved in other consumer credit activities such as debt counselling and debt administration.

44. Some firms may find that they are carrying on consumer credit activities simply by accepting the payment of their fees by instalments. Any form of financial accommodation (including time to pay) will amount to 'credit' but the arrangement will be exempt if the number of repayments does not exceed four, the payment term does not exceed 12 months and it is without interest or other charges. It is possible therefore, that a large number of firms will be affected by the transfer of regulation and the proposal set out in this consultation.

45. An additional impact of this proposal is that firms that become authorised by the FCA to carry on consumer credit activities will no longer be able to benefit from the Part 20 regime in relation to any other FSMA regulated activities, for example, insurance mediation activities. This is because a firm cannot be both

authorised by the FCA and an EPF at the same time. The only exception to this is in relation to firms that have been granted Interim Permission by the FCA as they are still able to benefit from the Part 20 regime until they become fully authorised by the FCA.

46. One of the main drivers behind the introduction of the DPB regime was to avoid dual regulation. However, in the case of consumer credit activities it seems likely that SRA-authorised firms would be required to comply with the same rules irrespective of whether they are authorised by the FCA to carry on these activities or are carrying them on under the Part 20 regime. This is not the way that the Part 20 regime operates in relation to other areas of FSMA regulated activities.

47. We understand that one of the consequences of the proposal is that firms might not wish to seek to be authorised by the FCA and therefore, decide to stop all consumer credit activity. This might mean that some consumers are unable to access consumer credit services that they have relied upon in the past. It is possible that the impact will have a disproportionate impact on vulnerable consumers, although we have no evidence to quantify this impact. However, an impact assessment will, be completed before a final decision is taken.

48. This proposal may appear to have an impact on those non-commercial organisations, not authorised by the SRA, that employ individual solicitors who previously relied on the group licence for consumer credit activities such as the provision of debt advice (debt counselling). These organisations, such as Citizens Advice Bureau, are most likely to fall into the definition of special bodies under Legal Services Act 2007 and currently benefit from transitional protection which means that they do not need to be authorised by an approved regulator. As they are not authorised by the SRA they are not able to benefit from the Part 20 regime and will need to be authorised by the FCA if carrying on consumer credit activities, consequently, they will not be affected by this proposal. It may be that these special bodies were also members of a collective group which had a group licence. If that is the case, the FCA have put in place measures for not-for profit organisations which allows them to continue carrying on consumer credit activities.

Timescales and next steps

49. We will continue our discussions with HM Treasury and the FCA. If it is decided that the SRA will not allow firms to rely on the Part 20 exemption for the purposes of consumer credit, then all firms carrying on regulated consumer credit activities will, from 1 April 2015, need to seek FCA authorisation. Firms that are concerned about the possibility of any gap between the 1 April 2015 and the date on which they are able to obtain authorisation from the FCA should apply to the FCA as soon as possible rather than waiting until the outcome of this consultation.

Consultation questions

1. Do you agree with the proposal that firms carrying on any regulated consumer credit activities should be required to seek authorisation directly from the FCA and not be able to rely on the Part 20 exemption set out in FSMA?

2. If you do not agree with the proposal, please offer any alternative suggestions for ensuring that the SRA's regulatory arrangements in relation to consumer credit activities are targeted, proportionate and do not result in the incorporation of the FCA's CONC and do not impose unnecessary costs and regulatory burdens on firms.

3. Do you have any views about our assessment of the impact of these changes and, are there any impacts, available data or evidence that we should consider in finalising our impact assessment?

4. To what extent are firms providing consumer credit services to clients which would mean that they would need to seek authorisation from the FCA? Are consumer credit arrangements more likely to be offered for particular types of work?

5. To what extent are firms providing other FSMA regulated activities which would mean that they would need to seek authorisation from the FCA?

6. If the proposal is implemented, will firms continue to provide consumer credit services, regulated by the FCA?

About you

As part of this consultation process, we would like to take the opportunity to ask SRA authorised firms to confirm:

i. whether they have been granted interim permission by the FCA; and
ii. the consumer credit activities that they carry on.

How to respond to this consultation

Online

Use our online consultation questionnaire {insert link} to compose and submit your response. (You can save a partial response online and complete it later.)

Email

Please send your response to consultation@sra.org.uk You can download and attach a Consultation questionnaire [insert link].

Please ensure that

- you add the title "SRA – Consumer Credit" in the subject field,
- you identify yourself and state on whose behalf you are responding (unless you are responding anonymously),
- you attach a completed About You form,
- you state clearly if you wish us to treat any part or aspect of your response as confidential.

If it is not possible to email your response, hard-copy responses may be sent instead to:

Solicitors Regulation Authority
Regulatory Policy - Consumer Credit
The Cube
199 Wharfside Street,
Birmingham,
B1 1RN

Deadline

Please send your response by 12 noon on Monday 15 December 2014.

Confidentiality

A list of respondents and their responses may be published by the SRA after the closing date. Please express clearly if you do not wish your name and/or response to be published. Though we may not publish all individual responses, it is SRA policy to comply with all Freedom of Information requests.