LEGAL SERVICES CONSUMER PANEL

Consultation response

SRA: Regulation of consumer credit activities and the SRA's role and obligations as a Designated Professional Body

Overview

1. **As we noted in our response to the SRA's first consultation on this subject matter, regulation of consumer credit activities is specialised and complex. Credit activities (and in particular debt collection) have a high scope for consumer detriment, often impacting most on vulnerable consumers.**
2. **In our previous response we set out why we believed that consumer credit regulation should remain with the Financial Conduct Authority (FCA). However we recognise that the SRA has identified merit in remaining within the FSMA Part 20 regime, and has worked constructively with the FCA to develop proposals for proportionate regulatory arrangements to allow it to do so.**
3. **Based on the revised proposals, the Panel supports the SRA's approach in principle, however there are several areas in which we would recommend enhancing consumer protection measures. The proposals as they stand do not strike the right balance between ensuring legal advice remains sustainable for non-commercial providers, while at the same time ensuring that consumers are properly protected.**
4. **We recognise that the SRA has tried to map its own scheme rules to match those within the FCA's Consumer Credit sourcebook (CONC). However it has not departed too much from original Office of Fair Trading regulations, and as such has yet to fully take account of dealing with vulnerable consumers and matters of affordability – both important considerations when undertaking lending and debt collection activities.**
5. **The SRA has also asked that consumer credit activities undertaken by a solicitor in the course of contentious business are excluded, and has in fact extended this to include pre-issue work. This would bring a large number of law firms that carry out debt collecting work outside FCA regulation. We still view this as inappropriate without accompanying safeguards for these consumers.**
6. **Finally, our response repeats the need for greater clarity on routes to redress when a complaint contains both legal and consumer credit elements.**

The proposals

7. The SRA proposals to regulate consumer credit activities carried on by SRA-authorised individuals and firms under Part 20 of the Financial Services and Markets Act 2000 (FSMA) follows an earlier consultation in which the SRA proposed withdrawing from this the Part 20 regime. This would have meant SRA-authorised firms carrying out 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).

8. The regulation of consumer credit was previously provided for under the Consumer Credit Act 1974 and administered by the Office of Fair Trading (OFT). Under this framework the OFT operated a group licensing regime, whereby individual SRA-authorised firms could carry out consumer credit activities without holding an individual licence, so long as they were overseen by the professional body. The group licence was held by the Law Society and managed by the SRA. Where the SRA identified a potential problem with an individual law firm they could refer that firm to the OFT who would assess whether to exclude that particular member from the group licence.

9. Regulation of consumer credit activities transferred from the OFT to the FCA on 1 April 2014 and the Consumer Credit Act 1974 provisions were replaced by FSMA. Part 20 of FSMA is the successor to the OFT group licensing regime and under it regulated members of a Designated Professional Body (DPB) can carry out consumer credit activities. They are regulated by the DPB (in this case the SRA), and the DPB must have rules in place that govern the carrying out of consumer credit activities. At the moment there are transitional provisions in place which allow law firms to rely on the Part 20 exemption until 1 April 2016.

10. However, because it is more difficult to satisfy the requirements of Part 20 FSMA than those of the old group licensing regime, and because the FCA has asked the SRA to incorporate a portion of the FCA rules into the SRA's rules, which the SRA feels would be incompatible with its approach to regulation, the SRA considered withdrawing as a DPB.

11. Following consultation on this, the SRA has arrived at the decision that there are benefits to remaining within the Part 20 regime, and as such has proposed a series of restrictions on how and what activities SRA-regulated persons can carry on. In order to protect the continuity of business, the SRA has proposed that activities can only be carried out under SRA regulation where the services are provided in a manner which is *incidental* to the provision of legal services.

12. It has also proposed that firms will be prevented from carrying out the following activities:

    - Entering into a regulated credit agreement as lender except where the regulated credit agreement relates to the payment or disbursement of professional fees
    - Exercising, or having the right to exercise, the lender's rights and duties under a regulated credit agreement except where the agreement relates to

the payment or disbursement of professional fees

- Entering into a regulated consumer hire agreement as owner
- Exercising, or having the right to exercise, the owner's rights and duties under a regulated consumer hire agreement, or
- Operating an electronic system in relation to peer to peer lending or entering into a peer to peer lending agreement

13. It has also proposed the following restrictions on firms carrying on permitted consumer credit activities, which will prevent firms from:

- Providing a client with a credit facility
- Holding a continuous payment authority (CPA) over a client's account
- Pawn broking
- Entering into a regulated credit agreement as a lender which is secured on land by a legal or equitable mortgage
- Acting as a lender under a regulated credit agreement which includes a variable rate of interest
- Providing a debt management plan to a client
- Charging a separate fee for the provision of credit broking services

14. Firms providing regulated consumer credit activities which are not incidental to the provision of legal services will need to apply to the FCA for consumer credit authorisation and would be dual regulated by the SRA and the FCA.

The Panel's response

15. The Panel has considered these issues using our consumer principles framework. In particular we have had regard to the principles of safety/quality, access, information and redress.

16. What we want to achieve as a result of this consultation exercise, is:

- Consumers who access credit and debt services via solicitors firms are able to do so in a **safe** manner;
- Consumers are able to **access** and pay for legal services in different ways, which best suit their individual circumstances and which allow them to smooth cash flow where needed;
- Consumers have the **information** they need to make good decisions, and know their rights and routes to redress; and
- Consumers have access to appropriate **redress** if something goes wrong.

Regulatory mapping

17. The Government's stated aim when making changes to the regulation of consumer credit was "to ensure that the consumer credit regulatory regime is equipped to deliver more robust consumer protection in the future."[1] Regulation of consumer credit

[1] See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221913/consult_transferring_consumer_credit_regulation_to_fca.pdf, p5, para 1.5

activities is specialised and complex. The SRA has recognised that there are detailed rules in place and that the FCA's approach to regulation is different to their own.

18. The SRA has attempted to map its existing principles and outcomes to the requirements of the FCA's Consumer Credit sourcebook (CONC). The view of the Panel however is that these changes do not reflect some of the FCA's key fairness principles; Principle 6 of the FCA's Principles for Businesses (PRIN) requires authorised firms to pay due regard to the interests of their consumers and treat them fairly[2]. Further, we would suggest making either explicit reference to, or importing, CONC 7.2.1 which requires firms to establish and implement clear, fair and appropriate policies and procedures for dealing with customers in arrears, and the fair and appropriate treatment of customers who the firm understands or reasonably suspects to be vulnerable[3].

19. Our view is that the current proposals do not provide for a robust enough framework for more vulnerable consumers.

Protections for consumers

20. Being a specialist regulator, the FCA is also in the position to identify and respond to consumer protection matters prevalent in financial services. This includes, particularly in the context of consumer credit, the notion of affordability being as important as that of creditworthiness. Affordability is a separate concept, and relates amongst other things to lifestyle and future expenditure commitments.

21. The SRA has drafted its Financial Services (Conduct of Business) Rules 2001 to reflect the need to assess a client's creditworthiness before entering into a regulated credit agreement, however we would strongly recommend including a requirement to also factor in the client's ability to make repayments. This is particularly important given the proposed plans to extend the number of repayments from four to 12. Arguably, solicitors are well placed to assess more individually what consumers can afford and that calculation might relate to case outcomes.

22. The Panel understands that under the proposals consumers would have differing routes to redress dependant on whether the firm was solely SRA authorised or dual authorised by both the SRA and the FCA. In these two situations, SRA-only authorised persons would need to signpost any consumer credit related complaints to the Legal Ombudsman, whereas any dual-authorised firms would direct consumer credit related complaints to the Financial Ombudsman Service. This is a potentially confusing situation not least to consumers but to providers also, and we would urge the SRA to ensure adequate clarity is provided, particularly in signposting to redress, so as to avoid consumers being referred between organisations. We would suggest that the SRA works with LeO and the Financial Ombudsman Service to clarify when and where complaints should be directed.

23. Finally, having two regulators in respect of consumer credit activities could lead to new challenges for monitoring as data will be

[2] See: http://fshandbook.info/FS/html/FCA/PRIN/2/1

[3] See: http://fshandbook.info/FS/html/FCA/CONC/7/2

held in more than one place. We would expect the FCA and the SRA to share data around any poor practice by solicitors, particularly as these proposals could potentially drive more SRA-authorised persons to seek dual regulation. The SRA would still have responsibilities to sanction individual solicitors for misconduct in relation to consumer credit activities where they are not dual regulated, however we would expect them to share any identified trends of relevance with the FCA, and vice versa, to ensure consistency of response.

Pre-issue work

24. The SRA has now secured an extension to exclude consumer credit activities that are undertaken by a solicitor in the course of contentious business to incorporate pre-issue work also. This brings a large number of law firms that carry out debt collecting work outside FCA regulation.

25. The Panel's view, as we expressed in our response to the previous consultation, is that this is inappropriate due to the fact that it is recognised that those who access credit and debt services may be particularly vulnerable due to their individual circumstances. Although credit is important in helping to smooth spending and giving people greater flexibility, some consumers may also get into problems and suffer detriment trying to pay back debts. These issues are especially acute in relation to debt collection, where consumers are particularly vulnerable and where has been historic poor practice. The impact is also potentially broader than just acting for lenders. This work may include casework around actions on behalf of any creditor - whether arising from a client's lending activities or other situations where debts occur such as utilities, housing, council tax and business transactions. Debt collecting in these circumstances should pay heed to good practice such as outlined in the Money Advice Liaison Group's Guidelines for helping consumers with mental health conditions and debt[4] (referred to in CONC).

26. Limiting the activities carried on under Part 20 to where it relates to professional fees, and where it is not a major part of the practice minimises the risks to consumers. However, all debt collection is high risk especially where mental health or dependants or other vulnerabilities are concerned. Debtors could be intimidated by solicitors so this underlines the importance of ensuring practices are fair, and that firms take account of vulnerability and affordability in collecting debts. Some of these practices are ongoing and the FCA's work in enforcement and supervision should be duly noted by the SRA to ensure any such practices are managed consistently across all firms.

Final remarks

27. We are disappointed to see that the SRA, despite committing to do so, did not conduct any impact assessment prior to this consultation.

July 2015

[4] See: http://www.malg.org.uk/dmhdocuments/Guidelines%202015.pdf