LEGAL SERVICES CONSUMER PANEL

Consultation response

SRA: Regulation of consumer credit activities

Overview

1. **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. **The Panel's view is that consumer credit regulation should remain with the FCA, as the specialist regulator, specifically set up to oversee financial activities. We support the SRA proposal that the FSMA Part 20 regime should not be available to law firms and any law firms carrying out consumer credit activities would need to seek FCA authorisation.**
3. **Another factor, is that the SRA is only able to issue 'traditional' law firms with fines of up to £2000, although the limit is very much higher for alternative business structures. We understand the SRA has made an application to the Ministry of Justice to increase the level of the internal fines it can impose. However, we still do not consider this is high enough to deter poor behaviour in relation to credit and debt activities. Additionally, the SRA does not currently have all of the other powers (such as restitution requirements) which the FCA has to deter poor practices and deal with consumer detriment.**
4. **The right balance to be found to ensure legal advice remains sustainable for non-commercial providers, while at the same time ensuring that consumers are properly protected. Regulation should be proportionate and not onerous. On balance, we consider firms which accept payment in more than four instalments, charge interest and accept payment terms in excess of 12 months should have to seek a consumer credit licence.**
5. **The SRA has also asked that consumer credit activities undertaken by a solicitor in the course of contentious business are excluded. Currently these exclusions do not cover pre-issue work. If the exclusions were to be extended to pre-issue work, they would bring a large number of law firms that carry out debt collecting work outside FCA regulation. We view this as inappropriate - in short we believe the FCA is best placed to regulate consumer credit activities as the specialised sectoral regulator.**
6. **Finally, our response identifies a need for greater clarity on routes to redress when a complaint contains both legal and consumer credit elements.**

The proposals

7. We write in response to the SRA proposal to withdraw from the Financial Conduct Authority's (FCA) Designated Professional Body (DPB) regime for the purposes of consumer credit activities. This means 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. Until recently the framework for consumer credit regulation was provided 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 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 2015.

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 is minded to withdraw as a DPB.

11. This will impact on law firms which carry out regulated consumer credit activities. These activities are most likely to involve:

    - Credit broking
    - Debt adjusting
    - Debt counselling
    - Debt collecting
    - Entering into a regulated credit agreement as a lender
    - Providing credit information services

12. Firms providing regulated consumer credit activities will need to apply to the FCA for a consumer credit license and would be dual regulated by the SRA and the FCA.

The Panel's response

13. In formulating this response we have kept in mind the consumer principles, which are a set of core principles commonly used by consumer organisations to help them work out how particular policy issues are likely to affect consumers. In particular we have had regard to the principles of safety/quality, access, information and redress.

14. 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.

15. We have also engaged with the Financial Services Consumer Panel and the Legal Ombudsman when preparing this response, and we would like to thank both organisations for their input.

A specialist credit regulator

16. There has recently been a large-scale overhaul of the consumer credit regime and the financial regulation landscape more generally. The Government's stated aim when making these changes 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 activities is specialised and complex. The SRA has recognised that there are detailed rules in place and the FCA approach to regulation is different to their own.

17. Moreover credit activities have a high scope for consumer detriment, often impacting hardest on vulnerable consumers. Such consumers may be in financial difficulties due to their individual circumstances, and there are potential impacts on many other areas of their lives, including debts becoming unmanageable, family break down and increased risk of mental health issues. Vulnerability is an area of current regulatory concern, and lawyers are not immune to carrying out poor practices which can impact heavily on those who are most vulnerable. We note that the SRA recently saw fit to warn in-house lawyers over debt collection practices, for example.[2] And the Solicitors Disciplinary Tribunal has previously sanctioned solicitors for aggressive practices such as sending intimidating letters to individuals demanding compensation and costs for alleged file sharing. These sorts of practices are of concern in the debt management sector.

18. Our view is that consumer credit regulation should remain with the FCA. The FCA is a specialist regulator, specifically set up to oversee financial activities. We support the SRA proposal that the Part 20 regime should not be available to law firms and any law firms carrying out consumer credit activities would need to seek FCA authorisation.

Protections for consumers

19. Aside from being a specialist regulator, the FCA is also able to take enforcement action against firms which fail to comply with its requirements. This includes the power to

[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

[2] See: http://www.sra.org.uk/sra/news/press/publicity-warning-notice-in-house.page

issue unlimited fines and to stop firms or individuals from providing regulated financial services. In addition to this the FCA can require information and documents, appoint an investigator, and impose restitution requirements.

20. The SRA is currently only able to issue 'traditional' law firms with fines of up to £2000, although the limit is very much higher for alternative business structures. We understand the SRA has made an application to the Ministry of Justice to increase the level of the internal fines it can impose to £10,000 for non-ABS firms. However, we still do not consider this is high enough to deter poor behaviour in relation to credit and debt activities. Additionally, the SRA does not currently have all of the other powers (such as restitution requirements) which are available to the FCA to deter poor practices and deal with consumer detriment.

21. Currently the Legal Ombudsman will consider complaints from clients related to the consumer credit activities of authorised persons. Third party complainants (such as those receiving aggressive debt collection letters signed by solicitors on behalf of corporate clients) may have recourse to the Financial Ombudsman Service (FOS). Should the proposals proceed, we understand the first group of complaints above would be handled by FOS.

22. However, uncertainty on who should deal with a complaint could arise where complaints contain both legal service and consumer credit elements. More generally, the arrangements could potentially undermine efforts to make the Legal Ombudsman the recognised body for all complaints about law firms. Further, there are differences in consumer protection between the two schemes, for example FOS has a higher compensation limit, but only the Legal Ombudsman will enforce an award in court on the consumer's behalf. (Although the FOS can refer firms that do not comply with a decision to the FCA, who can then take enforcement action, including revoking a firm's consumer credit licence).

23. While greater clarity is needed, these difficulties do not alter our overall conclusion that firms carrying out consumer credit activities should seek FCA authorisation. However, to mitigate the problems it will be important to provide clear information to consumers so they know their rights and routes to redress, and to put in place clear protocols between the two ombudsman schemes.

24. Finally, having only one regulator for consumer credit activities should make monitoring easier since data will be held in one place rather than scattered across different regulators. However, we would still expect the FCA to share data around any poor practice by solicitors with the SRA, and vice versa. The SRA would still have responsibilities to sanction individual solicitors for misconduct in relation to consumer credit activities.

Access to legal services

25. We are aware of the particular issue that if law firms accept payment in instalments they may have to apply to the FCA for a consumer credit licence. Firms will be exempt if the instalments number four or less, the payment term does not exceed 12 months, and there is no interest or other charges. However, some law firms which currently allow payment in instalments

under other terms may decide not to apply for a licence from the FCA and stop allowing payment in instalments. This has a potential impact on the availability of legal advice to consumers who are only able to access/pay for it in this way. There are additional potential impacts and/or burdens on solicitors employed in non-commercial providers, and on law centres and others which could end up falling under FCA regulation if the Part 20 exemption is removed. Furthermore, we are aware there has been commentary over the scope of the proposed new arrangements – they are likely to apply to a large number of firms.

26. The Panel has previously responded to consultations around non-commercial providers in legal services. Our goal has always been to ensure that providing legal advice remains sustainable for non-commercial providers, while at the same time ensuring that consumers are properly protected. This means it is key that regulation is proportionate and is not overly onerous – otherwise there is a real risk that non-commercial providers (and others) could exit the market, leaving consumers without a vital source of support. On the other hand we recognise that many clients will be vulnerable due to their personal circumstances, the characteristics of the legal services market, or a combination of the two. This is especially true in the context of provision of credit related activities.

27. The Panel takes a risk-based approach, and our view is that firms which accept more than four instalments, charge interest and accept payment terms in excess of 12 months should apply for a consumer credit licence. It is recognised that those who access credit and debt services may be particularly vulnerable due to their individual circumstances, and 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.

28. Businesses which hold a consumer credit license are obliged to have regard to various conditions, including affordability assessments and creditworthiness, to ensure consumers will be able to pay back what they borrow. There are also other safeguards, for example around adequate explanations and signposting requirements, treating customers fairly, and rules on defaults, arrears handling and forbearance. The Panel considers this is appropriate, but as we have explained, we are also keen to ensure that the FCA's regulatory approach is proportionate. In their Business Plan 2014/15 the FCA have committed to take a proportionate approach to consumer credit authorisation, taking into account higher and lower risk firms.[3] We also note that a two-tier approach towards authorising consumer credit firms is proposed, whereby firms carrying out higher risk activities will be subjected to more onerous requirements than those carrying out lower risk activities.

29. Unfortunately, there is a lack of data on ways in which consumers pay for legal services other than by bank transfer. What proportion of firms, for example, will accept payment by credit card? How often are

[3] See: http://www.fca.org.uk/static/documents/corporate/business-plan-2014-2015.pdf

legal services paid for through consumer credit mechanisms? We encourage further work to close these evidence gaps to evaluate the impact of the changes.

Pre-issue work

30. The SRA has asked the FCA and HM Treasury to exclude consumer credit activities that are undertaken by a solicitor in the course of contentious business. Currently these exclusions are only available where proceedings have been issued and do not cover pre-issue work. If the exclusions were to be extended to pre-issue work, they would bring a large number of law firms that carry out debt collecting work outside FCA regulation.

31. The Panel's view is that this is inappropriate for the reasons we have explored above. In short we believe the FCA is best placed to regulate consumer credit activities as the specialised sectoral regulator. These issues are especially acute in relation to debt collection, where consumers are particularly vulnerable and where has been historic poor practice. Some of these practices are ongoing and the FCA's work in enforcement and supervision should ensure any such practices are managed consistently across all firms.

Final remarks

32. We note the SRA have committed to carry out an impact assessment before a final decision is taken. We would urge them to do so and to publish the results.

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