

BRIEFING NOTE (FEBRUARY 2004 UPDATED JUNE 2004)
PROPOSED CHANGES TO THE CONSUMER CREDIT REGIME, INCLUDING REFORMS CONCERNING
CONSUMER CREDIT ON-LINE

THE EXISTING CONSUMER CREDIT REGIME

The consumer credit market in general terms comprises **secured lending** (other than those first mortgages which will be regulated by the FSA from 31 October 2004), **credit cards, loans, mail order, hire purchase, store cards and credit unions.**

Subject to certain exceptions, the Consumer Credit Act (“CCA”) currently regulates **consumer credit, consumer hire and related agreements** for amounts up to **£25,000**. Credit includes any form of financial accommodation (s 9(1) CCA). Its protections apply to agreements with individuals. **An individual is defined to include partnerships and other unincorporated bodies, unless all the members are corporate bodies** (ss 189 and 185(5) CCA). Additionally agreements for the bailment of goods are regulated consumer hire agreements under the CCA, if the hirer is an individual, the agreement is capable of lasting over three months, payments to be made by the hirer do not exceed £25,000 and the agreement is not exempt (s 15(1)). The CCA lays down rules covering: the **form and content of credit agreements; credit advertising;** the method of calculating the **Annual Percentage Rate (“APR”) of the Total Charge for Credit;** the **procedures** to be adopted in the event of **default, termination, or early settlement;** and the provision of **remedies in cases of extortionate credit bargains.**

THE PROPOSALS

On 8th December 2003, the DTI published a White Paper entitled “Fair, Clear and Competitive – The Consumer Credit Market in the 21st Century” (the “**White Paper**”) as part of its review of the CCA, including proposed changes to regulate the conclusion of online consumer credit agreements.

The White Paper outlines the Government’s proposals for reform of consumer credit under a number of headings including: (i) **establishing a more transparent regime by** (a) changing the advertising regulations to make credit advertisements clearer and simpler for consumers to understand, (b) providing consumers with **clearer information** before and after agreements are signed and **revising the form and content of agreements to make them clearer and more transparent,** (c) changing the law to prevent those who settle loans early from being penalised and (d) **enabling consumers to enter into and conclude agreements on-line;** (ii) **creating a fairer framework that encourages competition while stamping out irresponsible and unfair lending practices by** (a) **strengthening the credit licensing regime** in order to target rogue and unfair practices, (b) **changing the law to end unfair selling practices,** including replacing a limited extortionate test with a wider unfairness test as well as providing an effective dispute resolution mechanism and (c) **removing the £25,000 financial limit** that creates a two tier lending framework and impedes consumer protection (although it will be retained for certain types of business lending); (iii) **shaping the European agenda,** particularly in the context of two draft Commission Directives in the consumer sector¹; and (iv) **minimising over indebtedness .**

The proposed reforms will also implement into UK law certain aspects of the **Directive on the Distance Marketing of Consumer Financial Services (Directive 2002/65/EC) (“DMCFS”)** as it applies to **consumer credit,** although separate regulations proposed by **the Treasury** being consulted upon by the **FSA will apply that Directive to products regulated by the FSA.** Further, the implementation date of certain of these proposals is likely to coincide with the introduction of the FSA rules on the regulation of mortgages in October 2004.

¹ In September 2002 the European Commission published a draft revised Directive on consumer credit (“**Consumer Credit Directive**”) COM (2002) 443 final. On the 18th June 2003 the Commission published a draft Directive as a harmonisation measure, on **Unfair Commercial Practices in the field of consumer protection.**

SUMMARY

The regulations resulting from the White Paper's proposals will, have potentially far reaching implications for all providers of consumer financial credit products and services. **Postponement of the start date for certain of the new regulations to end of May of next year (and to later dates (see below) with regard to early settlement and existing loans), was conceded by the DTI,** to allow more time to change documentation and adjust systems to cope with all the changes. However the sheer volume of changes which will be implemented in part from October next, necessitates that all providers not delay in dealing with the changes.

OTHER PROPOSALS

In September 2002, the European Commission published a draft revised Directive on consumer credit², ("Consumer Credit Directive"). This aimed to fully harmonise the laws on consumer credit in the Member States. Whilst it was expected that the principles proposed by the White Paper, would be reflected in the draft Directive, the European Parliament has substantially redrafted the Directive, in particular they have altered the scope of the Directive and the level of harmonisation. **The DTI report that whereas the Commission had proposed total harmonisation, the European Parliament prefers 'optimum harmonisation' which in effect means that Member State would retain the right to go further than the standards laid down in the Directive. However, the rules on APR are likely to be subject to full harmonisation in order to facilitate the internal market.**

Additionally, on 18th June 2003 the Commission published a draft Directive as a harmonisation measure, on **Unfair Commercial Practices in the field of consumer protection**³. This draft Directive contains a prohibition on Unfair Commercial Practices and, as the DTI explain, it highlights two principal categories of Unfair Commercial Practices – misleading commercial practices (actions as well as omissions) and aggressive commercial practices. In each case, the Directive sets out criteria to establish whether a practice is misleading or aggressive and includes an annex containing a non-exhaustive list of examples of unfair commercial practices intended to demonstrate further application of the criteria. **Negotiations on the Directive are currently ongoing in Brussels**⁴.

IMPLEMENTATION TIMETABLE

In June 2004, certain draft regulations were published which substantially reflect the proposals in the White Paper to which they relate, although some changes have been made to accommodate industry responses to the White Paper.

The new regulations relating to **advertising**⁵, are expected to come into force on the **31st of October 2004 although a transition period of up to one year is being considered.** The new regulations relating to **form and content of regulated agreements**⁶ and relating to **disclosure of information**⁷ are expected to come into force on the **31st of May 2005** and the new regulations relating to **early settlement**⁸ are also expected to come into force at that time. Draft regulations to facilitate the conclusion of **consumer credit agreements on line** are expected to be laid before Parliament in September, with a view to their coming into force in **October 2004.** The Government indicate that they will **implement** the majority of the **DMCFS requirements relating to consumer credit on 31.5.2005. However they propose to implement the cancellation rights under the DMCFS by the 31.10.2004.**

² COM (2002) 443 final

³ COM (2003) 356 final.

⁴ The Directive is expected to be adopted in mid 2005, with a two year transposition period, although it is possible that the Directive will move much more quickly

⁵ The Consumer Credit (Advertisements) Regulations 2004

⁶ The Consumer Credit (Agreements) (Amendment) Regulations 2004

⁷ The Consumer Credit (Disclosure of Information) Regulations 2004

⁸ The Consumer Credit (Early Settlement) Regulations 2004

The Government propose **that the new regulations on early settlement, will apply to loans of under ten (10) years from 31st of May 2007 but will not apply to loans of ten (10) years or more until 31 May 2010.** The new regulations will not apply to existing loans which are currently unregulated.

The replacement of the limited “**extortionate test**” by a wider **unfairness test** is expected to be dealt with as part of the proposed **Consumer Credit (Amendment) Bill** which has not as yet been published. This bill may well be a consolidation measure but may cover other areas as well including **the removal of the £25,000 financial limit** described above. When the Bill will be published and then adopted will be determined by the Parliamentary timetable.

On the £25,000 limit, the government propose that they would retain the limit for business lending but restrict it appears, the definition of business lending covered by the CCA to credit agreements made with sole traders, unincorporated bodies and partnerships of three or fewer. However the DTI on reflection are proposing (as an additional test) a test for business lending that will mean that the CCA will not apply to transactions where the borrower is entering into the agreement “wholly or predominantly for business purposes”. The classification of an advance as a business loan will be evidenced principally by self certification on the part of the borrower. **At this point the plan is that these two tests will sit along side each other, although how this will be done will be clarified later. One could read the two tests as alternatives, however the current intention is not to do that.**

They are also indicating that they intend to further refine the definition of business lending to ensure that it covers lending secured on land or property that is intended for use other than as the family home – **the effect will be that only buy to let loans for less than £25,000 will be capable of being regulated under the CCA.** These changes may be introduced in part by statutory instrument and in part by the new Consumer Credit (Amendment) Bill.

The Treasury implementation of the **DMCFS** should also be noted. For example, the **withdrawal rights** contemplated by the **DMCFS**⁹ are likely to apply to deposit taking and certain other products for which currently there is no requirement. **This Directive is required to be implemented in UK law by 9th of October 2004.**

FURTHER DETAILS

A summary of the White Paper proposals as modified by the current draft regulations is available from

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⁹ The CCA provides detailed rules on cancellation/withdrawal, regulation 15 of the Electronic Commerce (EC Directive) Regulations 2002/2013 provide a right of rescission in certain circumstances, the DMCFS in Article 6 provides for a right of withdrawal and the original draft of the proposed revised Consumer Credit Directive provides for a consumer right of withdrawal in certain circumstances.