Solicitors Regulation Authority

Regulation of consumer credit activities Q&A

The FCA has also published information on its website [http://www.fca.org.uk/firms/firm-types/consumer-credit] which may be helpful to you.

Open all [#]

What are regulated consumer credit activities?

Regulated consumer credit activities are set out in Part 2 or 3A of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) and are also listed in the definition of 'credit-related activities' in the SRA Glossary. These include activities such as entering into a regulated credit agreement as lender, credit broking, debt adjusting, debt counselling, debt collecting, debt administration, providing credit information services and providing credit references.

How does consumer credit activity regulated by the FCA impact on SRA regulated firms?

From 1 April 2014 consumer credit activities became regulated activities under FSMA. An SRA-authorised firm will only be able to carry out regulated consumer credit activities including credit brokerage, debt collecting, debt advice, and debt management or administration etc. if:

1. the firm is authorised by the FCA to carry out this business by either full FCA authorisation or having been granted interim permission to continue to operate; or
2. the consumer credit activity is an exempt regulated activity under Part 20 of the FSMA.

Part 20 of FSMA sets out a number of conditions that must be met for a regulated activity to be exempt (see sections 327 and 332(4) of the FSMA). These include the following:

- the activity arises out of, or is complementary to, the provision of a particular professional service to a particular client;
- the manner of the provision by the firm of any service in the course of carrying on the activities is incidental to the provision by the firm of professional services;
- the firm accounts to the client for any pecuniary reward or other advantage which the firm receives from a 3rd party; and
- the firm does not carry on any activities regulated by the FCA other than those permitted under Part 20 of FSMA or in relation to which the firm is an exempt person.

Are the services being provided in an "incidental manner"?

The "incidental manner" condition (see above) is one of the conditions that must be satisfied for a firm to be able to benefit from the exemption in Part 20 which allows regulated activities to be carried on by firms authorised by a Designated Professional Body (DPB) (such as the SRA).

The FCA has stated in its Professional Firms Sourcebook at PROF 2.1.15 that in order to satisfy this condition in section 327(4) of FSMA regulated activities cannot be a major part of the practice of the firm. The FCA also considers the following further factors to be among those that are relevant:

1. the scale of regulated activity in proportion to other professional services provided;
2. whether and to what extent activities that are regulated activities are held out as separate services; and;
3. the impression given of how the firm provides regulated activities, for example through its advertising or other promotions of its services.

Therefore, it is unlikely that a firm which undertakes a regulated consumer credit activity, such as debt collecting, as a major part of their practice, would be able to satisfy the “incidental manner” condition in which case it would need to be authorised by the FCA.

Do you need to be authorised by the FCA for consumer credit activities?

If you carry on activities which meet the definition of regulated consumer credit activities and cannot rely on the exemption set out in Part 20 of FSMA (or any other relevant exemption or exclusion), you must be authorised by the FCA. You may have however, decided to cease the activity or amend your business model rather than consider FCA authorisation.

What is the Interim Permission regime?

Full details of how the interim permission regime works can be found on the FCA website. In summary the interim permission was available to firms who had their own standard OFT licence. Interim permission was not available to members of organisations who had previously benefited from the group licence regime operated by the OFT. Interim permission will run until April 2016 and is designed to allow firms who have previously been regulated by the OFT to continue trading while

transitioning across to the FCA regime. The FCA have begun their selection of firms to take them through the full authorisation process.

What if you already hold FCA authorisation for other mainstream financial services regulated activities?

If the firm already holds full FCA authorisation for a non-credit-related activity, it will not be able to benefit from the exemption under Part 20 of FSMA. This is because the effect of section 327(7) of FSMA is that an exempt professional firm (EPF) cannot be an authorised person. Instead the firm will need to vary its permission to include consumer credit activities.

The legislation only provided a grandfathering route into FCA consumer credit authorisation for firms that held a standard OFT consumer credit licence. As an FCA authorised firm, you will not be able to rely on the Part 20 exemption, even if you are carrying on credit activities which are "incidental" to professional services supplied to a client.

If a firm has interim permission, will it still be able to use the Part 20 regime for other regulated activities?

By virtue of a statutory instrument issued on 27 March 2014 (The Financial Services and Markets Act 2000 (Consumer Credit) (Transitional Provisions) (No. 2) Order 2014) a firm which relied on Part 20 as an EPF before 1 April 2014 and after that date has interim permission to undertake credit-related regulated activities can continue to use Part 20 exemption, for a transitional period, for other exempt regulated activities. This transitional period ends when the firm is notified by the FCA that it has "full" permission. At that point the firm will no longer be eligible to rely on Part 20 and will have to cease the activities carried on as an EPF. If you wish to continue to undertake such activities (after receiving full FCA permission for credit-related regulated activities) you should apply to the FCA for permission to undertake such activities.

If you are a law centre or an organisation which previously relied on the Law Society's group licence regime, how does the change impact on you?

The FCA decided that not-for-profit bodies which held an OFT licence prior to 31 March 2013 will be granted a limited permission authorisation for debt adjusting, debt counselling and providing credit information services to the extent that those activities were covered by its own particular OFT group licence. This does not constitute a new or extended group licence but a permission under the new FCA regulatory regime.

There are two relevant points:

Firstly, the Law Society is not a not-for-profit body. It therefore does not fall within the scope of the FCA permission. Indeed the limited number of organisations which do are specifically listed on the FCA website.

Secondly, the FCA permission refers to not for profit bodies which held their own group licences prior to 31 March 2014. This will not apply to individual solicitors working within organisations such as law centres which previously took advantage of the Society's group licence. These organisations will need therefore to make their own arrangements with the FCA.

Can you continue to carry on regulated consumer credit activities for clients if you do not have interim permission and cannot rely on Part 20?

From 1 April 2014 it is against the law to carry on regulated consumer credit activities for clients without FCA permission unless you can rely on Part 20. You will have to cease this work until you have been granted authorisation by the FCA.

What work can a firm do?

Full details of the consumer credit activities that have become regulated activities under FSMA and any relevant exclusions can be found in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). The Order was substantially amended by the Financial Services and Markets Act (Regulated Activities) (Amendment) (No.2) Order 2013 to bring in the new regulated consumer credit activities and has been further amended by subsequent Orders.

Firms will need to understand what activities are regulated under the RAO. Article 39F of the Order, for example, sets out what activities fall within "debt-collecting" and "credit agreement" is defined in article 60B of the same Order. Firms will need to consider whether their debt-collecting/recovery activities involve seeking payment of a debt which is due under a consumer credit agreement or hire agreement as only those debt- collecting activities will fall within the definition of the regulated activity of "debt-collecting"; other types of debt-collecting activities are not affected by these changes.

It seems fairly clear that firms that specialise in 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.

Details of prohibited and restricted activities are set out in the SRA Financial Services (Scope) Rules 2001.

What is a regulated credit agreement?

A regulated credit agreement is an agreement between a “relevant recipient of credit” or an individual (the borrower) and any other person (the lender) by which the lender provides the borrower with credit of any amount. A regulated credit agreement means any credit agreement which is not within the categories of exempt agreements. An example of an exempt agreement includes where the number of repayments to be made by a borrower is twelve or less, made over a period of 12 months or less and without interest or other charges.

See article 60B and 60C to 60H of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013 [http://www.legislation.gov.uk/ukdsi/2013/9780111100493] for further details.

What should you do if you are asked to represent a client in a litigation matter which has arisen from a consumer credit or hire agreement?

You should be able to do this without carrying on a regulated consumer credit activity as the secondary legislation that brings consumer credit activities within the FCA regime excludes consumer credit activities carried on by solicitors, or other persons authorised under the Legal Services Act 2007, in the course of providing advocacy services or litigation services. These services are defined as services which it would be reasonable to expect a person who is exercising, or contemplating exercising, a right of audience (or a right to conduct litigation), in relation to any proceedings, or contemplated proceedings, to provide for the purpose of those proceedings or contemplated proceedings. These definitions are sufficiently wide to cover pre- issue work and will also apply irrespective of whether proceedings are issued. The exclusion applies to various consumer credit activities, including debt collecting.

What should you do if a client asks for or requires debt advice as a result of another matter the firm is working on for that client?

This should meet the criteria set out in Part 20 of FSMA. The firm must comply with the SRA Financial Services (Scope) Rules 2001 and the SRA Financial Services (Conduct of Business) Rules 2001 but would not require FCA authorisation or permission. It should be noted that in order to meet the criteria in Part 20 the firm must make an assessment on a case by case basis but not necessarily on a matter by matter basis. It is not sufficient to assume that all situations will fall within Part 20.

Do credit activities include the postponement or staged payment of fees?

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 12 (this was previously four), the payment term does not exceed 12 months and is without interest or any charges.

Does the exemption in article 60F apply if the agreement to accept payment by instalments is entered into after the debt has been incurred?

In our view the exemption will not be available here. This is because the exemption only applies to borrower-lender-supplier agreements (these relate to financing of a transaction) and not to the re-financing of an existing debt.

If the exemption in article 60F is not available, then by entering into such an agreement with a client, you would be carrying on a regulated consumer credit activity i.e. entering into a regulated credit agreement as lender. However, it does not follow from this that you would need to be authorised by the FCA in order to carry on this activity. It is clear that where the agreement relates to the payment in instalments of a firm's invoice for professional fees then the relevant consumer credit activity would fall within the Part 20 exemption as this activity arises out of, or is complementary to, the other professional services that the firm has provided to the client. Therefore firms would be able to undertake this activity under the SRA's regulation and would not need to be authorised by the FCA.

Firms will, of course, be required to comply with the SRA Financial Services (Scope) Rules 2001 (Scope Rules) and the SRA Financial Services (Conduct of Business) Rules 2001 when carrying on any consumer credit activities. In particular, firms will need to consider rule 5.11 of the Scope Rules which requires firms, during the transitional period, to comply with various provisions and guidance, in relation to consumer credit activities, that were in force immediately before 1 April 2014.

Does the SRA's restriction relating to "pawn broking" impact on circumstances when a lien is exercised over client files/assets?

The restriction does not prevent a firm from exercising a lien over a client's files or assets. The restriction refers to "taking any article from the client in pledge or pawn as security for the transaction", this therefore deals with taking something as security *for the transaction* rather than keeping possession of a client's files/assets until a debt owed by the client is paid.

Are conditional fee agreements, and the use of, impacted in any way?

No, the use of conditional fee agreements are governed by legislation and rules which are unrelated to regulated credit agreements.

Is the holding of a continuous payment authority prohibited absolutely or only when used in relation to a regulated credit agreement?

The prohibition applies only in relation to regulated credit agreements. Where, for example, the firm has authority to make payments out of a client account under a Power of Attorney these arrangements will not be affected as they do not relate to a regulated credit agreement.

When acting as lender under a regulated credit agreement which relates to the payment of disbursements or professional fees can the firm charge the client a variable rate of interest?

No, a firm must not act as lender under a regulated credit agreement which includes a variable rate of interest. This includes fixing your interest rate by reference to a rate, such as the Bank of England base rate, which will itself vary over time.

Is the use of a Sears Tooth agreements, which in effect provides for security for a credit arrangement concerning fees, allowed under the SRA's regulatory arrangements?

The Scope Rules allow a firm to enter into a regulated credit agreement as lender where the regulated credit agreement relates to the payment of disbursements or professional fees. Therefore, firms should be able to use Sears Tooth agreements provided that they comply with any relevant restrictions including, for example, the restriction that the credit must not be secured on land by a legal or equitable mortgage.

Is a loan to a business partner to buy into a partnership included in the scope of the prohibitions?

An activity is not a regulated consumer credit activity unless it is “carried on by way of business” (section 22(1A) of FSMA), therefore, activities such as brokering partnership loans are unlikely to fall within this definition as this activity is not pursued as a business in its own right.

How are firms authorised by the FCA?

Firms will need to complete a more detailed application process for FCA authorisation.

The SRA understands that a proportionate approach to authorisation will be adopted through which firms will be assessed depending on their size, type and the credit activities. Firms will be placed into either "lower-risk" or "higher-risk" categories. Firms carrying out lower-risk activities will receive "limited permission".

The application form for authorisation will ask for information about your business, its structure and financial resources. You will need to demonstrate that you satisfy the FCA minimum standards and will continue to satisfy them as long as you are authorised. These standards are known as "threshold conditions"; for more information visit the FCA website [http://www.fca.org.uk/firms/firm-types/consumer-credit/authorisation] .

What are the FCA's authorisation fees?

Under the new regime, not all firms will pay the same amount. The fee payable will be proportionate to the size of the firm's business and the type of authorisation. Firms with "limited permission" are likely to have lower fees than those of higher-risk firms. See the FCA CP13/10. View detailed proposals for the FCA regime for consumer credit in further detail here [http://www.fca.org.uk/news/cp13-10-consumer-credit-detailed-proposals] .

Does the FCA have any further information?

Visit the FCA's website [http://www.fca.org.uk/] .