

A new approach to financial regulation: consultation on reforming the consumer credit regime
22nd March 2011

Community Development Finance Association response (FINAL v2)

The Community Development Finance Association (**cdfa**) is pleased to respond to the HM Treasury consultation on reforming the consumer credit regime.

The **cdfa** is responding on behalf of its 68 members comprised of Community Development Finance Institutions (CDFIs). CDFIs are non-commercial social enterprises which deliver an appropriate financial service to those in greatest need. CDFIs serve three markets: Civil society; small- and micro-business; and personal/consumer, providing credit where access to finance has been denied by mainstream financial institutions.

Our response has been informed via direct consultation with the membership.

1. Do you agree with this assessment of the consumer credit market?

A: Yes

2. Is this a fair assessment of the problems caused by the way in which consumer credit is currently regulated and issues that may arise as a result of the split in responsibility for consumer credit and other retail financial services?

A: The focus of the problems of split regulation are valid. However, the points of duplication, confusion, clarity and inefficiency are inherent in the variety of institutions that come under the wide scope of the CCA. The current differentiation in regulatory oversight mirrors the different activities of those firms which are overseen by FSMA and CCA, and makes sense in practice due to the inherently different nature of FSMA- versus CCA-regulated activities. Should the responsibilities be unified, care must be taken to avoid the potential for unintended consequences through indiscriminate application of the FSMA regime over CCA. The FSMA regime is structured to meet certain regulatory requirements – overseeing deposit-taking and other high-risk, high-impact activities – not all of which pertain to those functions undertaken by the CCA regime. There is no need for these rules to be applied to non-deposit taking institutions. FSA licensed vehicles by definition require greater regulatory burdens as they deal with consumers both on the depository and customer-based paradigm.

3. The Government would welcome further evidence relating to the consumer credit regime, including in particular:

- the types of risks faced by consumers in consumer credit markets;

A: Consumers face great risk from certain elements of the current consumer credit market, in particular the high-cost, exploitative sub-prime market (payday and other short-term small sum and home credit lenders), where APRs are often in the hundreds of percent. Conversely, community development finance institutions (CDFIs) – non-profit social enterprises trading for charitable purpose – provide credit responsibly to those unable to access it from mainstream sources at an average APR of 30% for consumers and 15% for consumers borrowing for business purposes. It would be unfair and simplistic to include CDFIs in a single category along with commercial sub-prime retail credit providers, but should instead be categories in a “charitable/community/social” category with distinct assumptions and oversight procedures explicitly devised expressly for them.

CDFIs provide socially-driven sets of products, all of which are designed to benefit the consumer. Rates of credit for home credit providers and CDFIs appear below:

Cost per £100 lent				APR			
Home credit providers		CDFIs		Home credit providers		CDFIs	
Average	Range	Average	Range	Average	Range	Average	Range
£68	£59 - £75	£17	£8 - £25	231%	164% - 300%	31%	14% - 44%

With regards pricing in the high cost credit market, we can clearly see CDFIs provide a much fairer deal for finance.

- key provisions for consumer protection under the current regime and their effectiveness in securing appropriate outcomes for consumers; and

No comment

- the incidence of regulatory duplications or burdens on firms and/or inconsistent regulation of similar types of business.

A: The current system of the FSMA regime for certain activities and CCA for others does not confer undue burden and it is not necessarily unreasonable to maintain a distinction between the two.

4. Do you consider these objectives for reform of the consumer credit regime to be appropriate and attainable?

A: Lack of flexibility within the CCA regime, especially with regards to the need to alter legislation to realise simple bureaucratic change justifies a unified approach; however, moving the entirety of the regime to the jurisdiction of a new agency in and of itself is not necessarily justified in order to achieve this.

5. The Government welcomes views on the impact a unified regulatory regime for retail financial services may have in terms of clarity, coherence and improved market oversight.

A: Although the premise of a unified regime may in principle confer theoretical benefits, the practicalities and consequences of doing so in this particular case are not necessarily founded and may not confer desirable benefits in reality. Transferring regulatory oversight of the credit market such that it is subsumed under a wider deposit-and-investment oversight regime as practiced currently by the FSA may bring about unwelcome and unnecessary stringency in approach and undue burdens in compliance. The rationale for doing so are, as yet, unsubstantiated.

6. The Government welcomes views on the role of institutions other than the OFT in the current consumer credit regime, and the benefits they may confer.

No comment.

7. The Government welcomes views on factors the Government or the CPMA may wish to consider in the event of a transfer of consumer credit regulation relating to how the overall level of consumer protection might best be retained or enhanced.

A: Simply retaining the same level of protection does not justify the significant resourcing required to transfer duties.

8. The Government would welcome further evidence relating to:

- the use of consumer credit by small and medium sized enterprises (SMEs);

A: Evidence taken from **cdfa's** annual member survey, *Inside Out 2010*, shows:

- 49 CDFIs hold a CC license; 45 of these have an average loan size of <£50k.
- Of these 45, total loans outstanding is 21,000 loans worth £79m; of these,
 - The personal loan portfolio is £7.6m (15,300 loans) and
 - The business and social enterprise lending portfolio £79m (21,000 loans)
- Consumer loans for enterprise purposes:
 - £71.3m outstanding (3100)
 - Approximately one-third of these were to unincorporated businesses (estimate)

- whether the protections currently afforded by the CCA are appropriate and cover the right groups of businesses; and

A: Maintaining the current regulations on agreements for business purposes of up to £25,000 for sole traders, small partnerships and other unincorporated bodies is prudent. However, care must be taken to prevent FSMA-style regimes dictating unnecessary attention; and so, for example, larger loans which are wholly or predominantly for business purposes should not be subject simply due to the fact that such scrutiny exists therein. FSMA regime should not be allowed to indiscriminately supplant tenets which have been deemed sensible and justified under CCA.

- the costs and benefits of considering extending FSMA-style conduct of business rules to a wider group of SMEs.

A: The benefits of capturing a wider pool of consumers under CCA enforced under a FSMA regime are unclear however the cost to those businesses not currently subject to CCA rules would be burdensome. Without requisite details, a cost benefit opinion is impossible here.

9. The Government welcomes views on how consumer credit firms and consumers may be affected by the increased flexibility that could be provided by a rules-based regime.

A: A rules-based rather than legislative regime should allow greater flexibility. It remains unclear why such a shift would also require oversight by another potentially more burdensome regime than the current agency.

10. The Government welcomes views on the impact a FSMA-style supervisory approach may have in terms of ensuring effective and appropriate consumer protection.

A: Although a risk based approach is acceptable in principle, care must be taken to apply it judiciously. Enhanced proportionality would confer a potential primary benefit of a graduated risk-based approach to supervision and intervention so long as the focus on regular reporting is kept within the same standard as currently required.

Doorstop lenders, payday loan companies and high cost credit providers such as Provident Financial do operate in higher risk markets with their activities more likely to cause consumer detriment. The government must be extremely careful to avoid applying this categorisation to social lenders such as CDFIs. Although operating at the high risk end of the market, the social and ethical goals of CDFIs place them in a distinct and separate category, one that should not be subject to measures directed at for-profit high risk lending.

Consumer detriment is not associated with CDFIs. CDFIs are beholden to their triple bottom line ethos, and **cdfa**-member CDFIs adhere to a Code of Practice which was devised by the **cdfa** in conjunction with the FSA. In fact, much of the motive for establishing a CDFI sector is to provide a marketplace for those excluded by mainstream financial service provision to go rather than resorting to for-profit, high-cost providers. CDFIs redress and reverse crippling debt cycles and help people pull themselves out of poverty.

It is, therefore, inappropriate to charge any or full CCL fees to CDFIs. A clear distinction between social lenders such as CDFIs and high cost for-profit lenders when assessing a risk-based approach to a fee structure is necessary.

11. The Government welcomes views on the synergies afforded by the current regime in tackling problems associated with the sale of goods and services on credit, and how these might best be retained in the design of a new regime.

No comment.

12. Do you agree that transferring consumer credit regulation to a FSMA-style regime to sit alongside other retail financial services regulation under the CPMA would support the Government's objectives (as outlined in paragraph 1.18 of Chapter 1)?

A: Provided that the FSMA regime does not supersede the spirit of CCA approach.

13. Are there other advantages or disadvantages that you consider could result from transferring consumer credit regulation to sit alongside that of other retail financial services?

A: Flexibility advantages must not be the only drive in a restructuring, which must also ensure that powers are not unnecessarily broadened to cover activities which are outside of the intended consequences.

14. Are there specific issues that you believe the Government should consider in assessing the merits of option 1? How could these be addressed in the design of a new regime as proposed in option 1?

A: Consider if the supposed benefits outweigh the cost of such a significant overhaul and ensure that unnecessary additional and burdensome requirements are not applied indiscriminately.

15. If you do not agree with the Government's preferred option 1, do you have views on the factors set out in paragraph 2.4 that the Government should consider in determining the most appropriate regulatory authority for the CCA regime under option 2?

No comment.

16. The Government welcomes views on the suitability of the provisions of a FSMA-style regime, such as those referred to in paragraph 3.6, to different categories of consumer credit business.

A: Applying FSMA-type provisions to different categories of consumer credit business would be acceptable provided that the provisions of the FSMA regime are applied to consider credit licensees based on CCA, not FSMA, requirements – for example, not requiring the additional material that would be required for a full FSA authorisation application requiring designation of the Approved Personal regime, and so forth.

17. Do you agree that statutory processes relating to CPMA rule-making, a risk-based approach to regulation and differentiated fee-raising arrangements could provide useful mechanisms in ensuring that a proportionate approach is taken to consumer credit regulation under a FSMA-style regime?

A: Assigning differential fees based on consumer credit business type is fair and reasonable both between and within categories. Those conducting advisory or other such “low-risk” activities should, rightly, be subject to a different, lower-cost fee structure. Assignment of fees to providers of credit should also be based on clearly defined criteria such as those defined in the consultation document, e.g., business size and presumed regulatory burden.

With regards to social lending CDFIs, there is an argument that although social lenders certainly ought to be regulated, the cost of regulation should be reduced, perhaps partly subsidised by the other regulated entities. If the cost of being regulated by the FSA would be higher than OFT regulation, there is an argument that such is contrary to the public interest. It is in the interest of the public that regulation should be as cheap as possible to obtain and maintain for lawful providers. It is contrary for the public interest for the cost to dissuade providers from entering the market, or pursuing a path of compliance. It is particularly in the public interest that social lenders should be sheltered. Particularly in the current very difficult economic conditions, but also on principle.

18. The Government welcomes views on key factors that would need to be assessed in considering fee arrangements for consumer credit firms.

A: One criterion not cited in the consultation is the determination a fee structure based on the mission and of credit providers. Accepting that all providers of credit – even those which operate for bona fide charitable purpose and for social outcomes – should be subject to regulatory oversight, a clear and defensible argument can be made to exempt such businesses from paying a (full) fee, with relatively negligible incremental adjustment in the fee structure of commercial business offsetting waived or greatly reduced fees. Charitable-purpose/social providers of credit – CDFIs – put their customers first and foremost and are therefore low-risk businesses with regards to the potential for bureaucratic resource burden that any regulator might bear due to degree and amount of involvement from adjudicating consumer protection rules. A categorisation process would be simple to design and easily executed. An initial screening process whereby membership in the **cdfa** (which requires demonstration of a commitment to community and economic development within disadvantaged communities or within markets that are not adequately served by mainstream financial service providers, and complying with a Code of Practice) could serve as a pre-condition, alongside demonstration of social value evidenced by the Memorandum of Association. A proportionate approach requiring an even lesser degree of scrutiny, given that most CDFIs are not deposit takers, is in order.

The structure of Consumer Credit Licensing (CCL) fees needs to be revised to apply a provision of exemption to social providers of finance. Whilst Credit Unions are exempt from paying CCL fees, CDFIs, operating under the same remit as Credit Unions, must pay the full CCL fee.

CDFIs deliver against a ‘triple bottom line’ of greater economic growth, social cohesion and sustainable development, screening responsible lending decisions by larger societal interests and impacts rather than by profit.

The fee paying structure should be revised such that either:

- **cdfa**-member CDFIs are exempt under the same rules as are Credit Union, or
- A Set of Principles sets parameters which would enable individual CDFIs to qualify for a fee exemption or reduction

These principles could easily be designed based on legal status the business trades by, such as:

- Registered charity - bound to be social, clearly in the public interest

- Community Interest Company - bound to be social, clearly in the public interest
- Ben-Com/Co-operative/IPS - very likely to be social and in the public interest
- Friendly Society/ Mutual - very likely to be social and in the public interest
- Company limited by guarantee - strong argument because a CLG is normally set up so it cannot distribute its profits or assets to its members. In other words, it should qualify if the CLG includes the lock on distribution of profits and assets.

19. The Government welcomes: evidence relating to experiences of the current appointed representatives regime; views on how an appointed representatives model might be applied to different categories of consumer credit activities, including how current business models and networks might lend themselves to such an approach; and evidence relating to the implications an appointed representatives regime might have for firms and consumers.

No comment

20. The Government welcomes: evidence relating to experiences of the current group licensing regime; and views on how the professional bodies regime might be adapted for different categories of consumer credit activities.

No comment

21. The Government welcomes views on the extent to which self-regulatory codes might continue to deal with aspects of lending to consumers and small and medium enterprises.

No comment

22. Do you consider that there would be a case for deregulation of certain categories of consumer credit activity in the event of a transfer? Please explain why.

A: Deregulation of those activities which are low/no-risk to consumers, are redundant and or would pose no impact on economic stability could, arguably, benefit from deregulation. Drawing distinctions between different forms of credit with regards to business mission, namely creating different rules for non-profit CDFIs, should be included in the scope for deregulation.

23. Are there other ways in which the design of a new consumer credit regime based on a FSMA-style framework might ensure a proportionate and effective approach?

No comment

24. The Government welcomes views on how the treatment of agreements already in existence could be approached.

A: Care must be taken to ensure that no unintended consequences result from any transition.

25. The Government welcomes views on:

how existing licensees could be dealt with; and

factors that should be considered in determining whether a modified approach could be adopted for particular categories of licensed firms.

No comment

26. The Government welcomes views on key factors that would need to be considered in transitioning from the current to a new fee structure.

No comment

27. Are there other factors the Government should take account of in considering transitional arrangements?

No comment

28. The Government would welcome evidence on the experience of firms, consumers and their representatives in relation to similar previous transitions, for example the extension of FSA jurisdiction to new markets since 2000.

No comment