

Think Piece

Mis-selling of consumer credit in the UK: gateways to redress?

With around £9bn of Payment Protection Insurance (PPI) potentially mis-sold to UK consumers the issue of the mis-selling of financial products has been big consumer news. More so, since the banks unsuccessful legal challenge to the Financial Services Authority's (FSA) Policy Statement on how firms should handle PPI complaints last April.¹

The gateway for consumer redress in the PPI market was the FSA's principled based approach to regulation, with its overarching focus on 'Principles' and fair consumer outcomes, as opposed to highly detailed and technical rules which are more susceptible to circumvention by contract law and complex legal process.²

For example, consider the Office of Fair Trading's (OFT) unsuccessful challenge to overdraft charges in the UK Supreme Court, which turned upon a very narrow legal argument on the application of the Unfair Terms in Consumer Contract Regulations (UTCCR) 1999.³

Because the banks were able to establish that such charges were contractually part of a fee for a package of services, the part of the regulation founded upon could not apply as the core price of a contract was beyond the scope of the UTCCR. Contrast this position with the mis-selling of PPI, where the FSA was able to rely upon Principles 1, 6, 7 and 9, which were immune to circumvention by clever contractual drafting or careful legal argument:

Principle

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| 1 Integrity | A <u>firm</u> must conduct its business with integrity. |
| 6 Customers' interests | A <u>firm</u> must pay due regard to the interests of its <u>customers</u> and treat them fairly. |
| 7 Communications with clients | A <u>firm</u> must pay due regard to the information needs of its <u>clients</u> , and communicate information to them in a way which is clear, fair and not misleading. |
| 9 Customers: relationships of trust | A <u>firm</u> must take reasonable care to ensure the suitability of its advice and discretionary decisions for any <u>customer</u> who is entitled to rely upon its judgment. |

Consumer credit in the UK is currently regulated by the OFT in accordance with the Consumer Credit Act 1974 (the CCA) as amended by the Consumer Credit Act 2006 (the 2006 Act). The UK Government has now indicated its intention for the new Financial Conduct Authority (FCA) to regulate part of the current CCA market, however, it remains the case that consumer credit does not enjoy the same principled-based regulation as insurance products, and other areas of the FSA's regulatory jurisdiction from the Financial Services and Markets Act 2000 (FSMA).

Yet new changes from the 2006 Act have effectively introduced, in part, a 'principled-based approach' to consumer credit agreements in relation to treating customers fairly. Could these changes represent a potential gateway for consumer redress for the mis-selling of consumer credit?

1 *BBA v. FSA, FOS and another* [2011] EWHC 999 (Admin)
<http://www.bailii.org/ew/cases/EWHC/Admin/2011/999.html>

2 <http://www.fsa.gov.uk/handbook>

3 http://www.supremecourt.gov.uk/docs/uksc_2009_0070_judgmentV3.pdf

The purpose of this brief paper is to explore that hypothesis.

Fairly sold, and fair consumer credit products

On 6 April 2007, section 140A of the CCA introduced a new 'unfair relationships test' (URT), which replaced the previously unworkable extortionate credit bargain test.⁴ Provision was made in schedule 3 of the 2006 Act for the URT to apply retrospectively in certain circumstances to consumer credit agreements entered into before 6 April 2007.⁵ Section 19 of the 2006 Act introduced the new section 140A to the CCA, which provides as follows:

“140A Unfair relationships between creditors and debtors

(1) The court may make an order under section 140B in connection with a credit agreement if it determines that the relationship between the creditor and the debtor arising out of the agreement (or the agreement taken with any related agreement) is unfair to the debtor because of one or more of the following—

(a) any of the terms of the agreement or of any related agreement;

(b) the way in which the creditor has exercised or enforced any of his rights under the agreement or any related agreement;

(c) any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related agreement).

(2) In deciding whether to make a determination under this section the court shall have regard to all matters it thinks relevant (including matters relating to the creditor and matters relating to the debtor).

The effect of section 140A(a) and (b) is to require a consumer credit agreement and the way it is enforced to be fair, while paragraph (c) is focused upon anything done or not done by the creditor (or upon their behalf) *before or after* the agreement is made. Accordingly, how a consumer credit product is sold will be caught by s.140A(c).

Mis-selling in practice?

Significantly, there is no definition of 'unfair' or 'fair' in the 2006 Act which can only mean that fairness must be widely construed, in accordance with its ordinary and natural meaning.⁶ What might this mean in practice? Let's take two common scenarios from everyday life:

- Mr and Mrs Smith are sold a second secured loan of £40,000 by a High Street finance company in 2008. The rate of interest was 11% APR over 10 years. Mr Smith was 63 and Mrs Smith was 65 when they were sold the loan. The contractual payment is £540 per month. Two years later, the Smiths find it impossible to pay the loan when they retire and their income drops to state retirement pensions. In 2012, Mr Smith is now 67 and Mrs Smith is 69 and for the last two years they have only been able to afford £200 per month and very large arrears have accrued, with the threat of repossession looming.
- Judy Reid has a full-time job but she has an impaired credit rating from previous financial problems and ongoing debts after she separated from her partner, and finds it difficult to access affordable credit. In October 2011 she is struggling to pay for car repairs and takes out a pay day loan. She does this online and completes an application approved in 15 minutes. The criteria for her loan was some form of employment. Judy borrows £100 for

4 <http://www.legislation.gov.uk/ukxi/2007/123/contents/made>

5 <http://www.legislation.gov.uk/ukpga/2006/14/schedule/3>

6 See, for example, http://www.ofc.gov.uk/shared_ofc/unfair-relationships/barnes-black-horse.pdf and the cases summarised here: <http://www.ofc.gov.uk/about-the-ofc/legal-powers/legal/cca/CCA2006/unfair/unfair-rel-full/>

one month at a cost of £42.96, with an equivalent APR of 4,214%. Judy finds she is again short of cash and is offered a 'roll-over' of the loan to the next month with an extra charge. Judy keeps rolling over the loan and is now liable to pay £400 in February 2012. Her overall financial position is now significantly worse than when she borrowed the £100.

Fairness principles for redress?

The s.140A fairness principles that arise in Mr and Mrs Smith case can be summarised as follows:

- Any creditor selling a loan must exercise reasonable care which would include properly assessing repayment affordability and creditworthiness over the period of the loan;
- As Mr and Mrs Smith were approaching retirement, it would have been fair and reasonable for the creditor to have ascertained how the customers could have met the payments once their income dropped upon retirement and advised them that this product would not have been suitable for them, or in their particular interests;
- In relation to the financial position of the customers, it would have been fair for the creditor to have advised them that it was highly likely their home would be repossessed in they took this loan out, and ultimately not offered the loan, and not secured the loan on their home; and
- As the consumer credit agreement was being secured on the free equity of the customers' home the creditor was in a position of trust and if it have acted fairly in the best interest of its customer and properly checked and explained the lack of affordability of the loan, it would not have sold the product to the customers, or the customers would not have purchased it or secured it on their home.

Turning to Ms Reid's case, the s.140A fairness principles can be summarised thus:

- Any creditor selling a loan must exercise reasonable care which would include properly assessing repayment affordability and creditworthiness over the period of the loan;
- In relation to pay day loans there is no fair or proper affordability checks as the lending takes place instantly online;
- In relation to pay day loans there is no fair, proper or sufficient explanation given to the customer of the suitability of the loan and the financial consequences of not settling the loan within the contractual term;
- The selling-method of pay-day loans and the absence of any cooling-off period, takes advantage of vulnerable consumers; and
- The relatively very expensive APR equivalent cost of the loan and use of roll-overs can entrap the consumer in a cycle of debt which grows unfairly in size and becomes increasingly more difficult to break the cycle of the debt; all of which would not have been clear or apparent to the consumer at the initial point of purchase.

In relation to our two examples, it will be apparent that there is at least a *prima facie* argument that both credit agreements entered into were either mis-sold and/or were unfair, however, the remedy provided by section 140A is court based.

Section 140B of the CCA gives the court a wide range of powers where it considers a relationship to be unfair, including altering the terms of the agreement, or reducing or discharging any sum payable under the credit agreement. Raising court proceedings will not be accessible or desirable for most consumers for a number of practical reasons (including complexity and the risk of legal expenses).

Financial Ombudsman Service

There is an alternative option as section 59 of the 2006 Act amended FSMA to create a new 'consumer credit jurisdiction' for the FOS.⁷ Consequently the FSA's 'DISP' rules for complaints

7 <http://www.legislation.gov.uk/ukpga/2006/14/section/59>

were amended to include this new jurisdiction, which means that the FOS can deal with 'consumer credit activity' complaints generally.⁸ Such complaints include acts or omissions in relation to the CCA or activities generally in relation to the regulated credit agreement.

Ultimately, arguments as to mis-selling or fairness in relation to s.140A, and the fairness of consumer credit products generally, would all be potentially relevant as the FOS determines complaints on the basis of what is “fair and reasonable in all the circumstances of the case”.⁹ That is a very wide remit, and where an unfair relationship resulted in clear financial and personal hardship for the consumer, then there must be a reasonable prospect of obtaining redress through the FOS.

Conclusion

The mis-selling of consumer credit products may not feature prominently on anyone's radar at present, but the selling practices of many licensed providers (including pay-day loans and second charge mortgages) – and indeed the features of certain products – should certainly ring alarm bells. Ultimately, it would appear that there are two major gateways available for vulnerable customers who require consumer redress. Looking forward, the product intervention and banning powers and principled-based regulatory approach of the new FCA may be as much needed in the consumer credit space as elsewhere.

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⁸ <http://fsahandbook.info/FSA/html/handbook/DISP/2/4>

⁹ <http://www.legislation.gov.uk/ukpga/2000/8/section/228>