



HM TREASURY CONSULTATION: FINANCIAL SERVICES FUTURE REGULATORY FRAMEWORK REVIEW

Finance & Leasing Association response – October 2019

Introduction:

1. The Finance & Leasing Association (FLA) is the leading trade association for the UK consumer credit, motor finance and asset finance sectors. FLA member companies include banks, the finance subsidiaries of major manufacturers and independent finance firms. They offer credit services to customers from all social groups, via credit and store cards, personal loans, point of sale finance, motor finance and a number of other consumer credit products, as well as a wide range of leasing and hire purchase services to businesses of all sizes.
2. In 2018, FLA members provided £137 billion of new finance to UK businesses and households, £46 billion of which helped consumers and businesses buy new and used cars, including over 91% of private new car registrations. £104 billion was in the form of consumer credit, accounting for over a third of all new consumer credit written in the UK. £33 billion of finance was provided to businesses and the public sector to support investment in new equipment, representing over a third of UK investment in machinery, equipment and purchased software in the UK last year.
3. Our members provide both regulated and exempt lending and are subject to regulatory oversight by the Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA) and the Competition and Markets Authority (CMA). The Financial Ombudsman's Service (FOS) also plays a quasi-regulatory role in interpreting FCA rules and guidance. The FLA's Lending Code and Business Finance Code have also formed part of the overarching regulatory framework for over 25 years, providing additional protection for customers.
4. Our members operate in a complex and ever-changing regulatory landscape. Whilst regulation aims to maintain fair competition, fair treatment of customers, and economic stability, the complexity of the regulatory landscape can create outcomes which do not meet these aims. With around 38,000 firms operating in the consumer credit sector alone, it is essential that regulatory requirements are clear and accessible so all firms know what is expected.
5. In reviewing the regulatory framework, we recommend HM Treasury (HMT) seeks to consider how to reduce this complexity and ensure that regulation does not limit the ability of FLA members to provide finance to both consumers and businesses, in support of the UK economy.

Understanding of the market

6. In order to be effective, regulators must have a good understanding of the markets they are seeking to regulate. Without a good understanding of the markets, regulation can be poorly drafted or inconsistently applied. For example, the



regulatory perimeter imposed by the Consumer Credit Act (CCA) can be poorly understood by the FOS. The FLA has been made aware of numerous cases in which businesses legitimately within the scope of the regulatory perimeter have had their complaints to the FOS rejected on the grounds they are out of scope.

7. We would urge the Government to consider how it can ensure that the regulatory perimeter is well understood by regulators. The FOS' Stakeholder Panel for businesses is a positive step in achieving this aim and we would support similar moves to increase stakeholder engagement in the regulatory process across all regulators.
8. Any review of the regulatory landscape should also consider the rapidly changing nature of the finance marketplace for businesses and consumers. For example, the CCA is nearly 50 years old and predates the era of widespread internet access, app-based banking and other innovations in financial services. In particular, the requirements for customer information and documentation should be modified to allow lenders to provide this information digitally and without the requirement for a written signature. The FCA has recently undertaken a detailed review of the CCA, setting out proposals for change. We would urge the Government to take forward these changes as soon as legislative time permits, so the CCA fully reflects how consumers want to apply for, and manage, their credit in the 21st century.

Working Together

9. It is essential that the regulators work together effectively, to avoid a siloed approach to regulation, which results in additional cost and inconsistency for firms. The existing Memoranda of Understanding and arrangements appear to work well, however there remain situations where greater collaboration is needed at a much earlier stage.
10. One recent example is the Government's proposed Breathing Space scheme. HMT are finalising regulations for the scheme, which will be introduced in 2021. However, the tight parliamentary timetable means there will be little time for detailed consultation on this far reaching legislation. There remain many questions and uncertainties, and the FCA will need to update its rules and guidance as a result. If more time had been allocated to working more collaboratively during the development of these regulations, firms would have a greater understanding of how the scheme will work in practice and what they need to do.

Bank vs non-bank lenders

11. The regulatory landscape differs considerably for bank lenders as compared to non-bank lenders. Banks are subject to regulation by the PRA, yet non-bank lenders are not. This potentially creates competition issues and a more confusing regulatory landscape. The Government may wish to consider how to minimise the impact of the differing regimes for bank and non-bank funders. This situation can be further skewed when the European Banking Authority publishes guidance which may be at odds with regulatory requirements already set by the FCA or PRA. One recent



example was the EBA's draft Loan Origination Guidelines which are inconsistent with some of the rules for credit and mortgages set out in the FCA's Handbook (CONC and MCOB). This inconsistency generates confusion.

Prudential Regulation:

12. The PRA apportions risk weighting to different types of finance, setting out the minimal capital a funder is required to hold. As part of the review of the future regulatory framework, the Government should consider reviewing the risk weighting of asset finance. Asset finance products present a lower risk of capital loss for funders than other forms of finance. In the event of non-payment by the customer the asset is recoverable and will typically retain a significant portion of its saleable value at the time it is recovered. However, asset finance funders are still required to hold capital equal to the value of the agreement. This does not protect the funder or the customer and has the ultimate effect of reducing liquidity in the market and reducing access to finance for small businesses. Greater liaison between regulators would ensure that each regulator has a rounded understanding of the different types of finance provided by funders.

Financial Ombudsman Service (FOS):

13. The FOS, although not a regulator, often acts as a *de facto* regulator of last resort as its decisions set precedents where the FCA has not previously considered an issue or where its principles-based regulation has not been prescriptive. As the FOS makes its decisions based on the individual merits of each case, this creates the risk that further 'regulation' is created without taking into account wider considerations. It also makes it less likely that lenders will be aware of the new precedent, as there is no consultation or engagement process for FOS decisions of this nature. Lenders may not become aware of any changes in requirements until an Ombudsman decision is published – and not all complaints of this nature will be published.
14. We would recommend that where a decision by the FOS in relation to a complaint has created precedent or has the potential to place a formal interpretation of what FCA regulation means in practice- these decisions are reviewed by the FOS in consultation with industry and the FCA.
15. The review by Lord Hunt into the FOS in 2008 ("*Opening Up, Reaching Out and Aiming High: An agenda for accessibility and excellence in the Financial Ombudsman Service*") made a number of recommendations in this regard which have not been taken up by the FOS. These recommendations should be revisited to help the FOS deliver better outcomes and improve coordination with other regulators.
16. For example, Lord Hunt states that "*The FOS Board should constantly be on its guard for any instances where the FOS is in danger of becoming a quasi-regulator or quasi-legislator as a consequence of gaps in either the regulatory structure or the law, drawing such instances urgently to the attention of the relevant public body and detailing them as a matter of course in the FOS Annual Report*". We would strongly support such an approach being taken by the FOS.



17. The FOS should work to identify where its practice diverges from regulatory rules and work with regulators to achieve alignment. This will deliver greater regulatory certainty for both firms and consumers.

Recommendations

18. We recommend that the Government ensures the regulatory landscape is responsive to the needs of the market by ensuring that there are sufficient opportunities for the industry to feedback to regulators, such as through industry stakeholder panels. For example, is representation on the FCA's Practitioners' Panel and Smaller Business Practitioner Panel sufficiently representative of regulated firms?
19. In light of the UK's forthcoming exit from the European Union, we suggest that the FCA takes the opportunity to update the customer information and documentation requirements (so they can be more readily understood by consumers) and reviews the proportionality of these requirements as applied to business customers - taking particular regard of the way in which technology can be used by lenders in delivering these communications.
20. To meet the needs of the diverse credit market, we recommend that the Government considers how bank and non-bank lenders are regulated to ensure a consistent, proportionate and predictable regulatory landscape for customers.
21. In light of coming changes to the rules on prudential regulation, we would support a review of the risk weighting of asset finance products, to ensure that the prudential regulation requirements that apply to these products are in line with the true risk faced by the funder.
22. As the FOS frequently acts as a *de facto* regulator of last resort, it would be appropriate for the Government to consider a review of the FOS and its ability to act in this way, taking into account the recommendations of the 2008 Hunt review.
23. While all new regulation is accompanied by a Cost Benefit Analysis, it is only once the new requirements are in place that the full impact can be assessed – for both firms and their customers. More post-implementation reviews should be undertaken, together with assessments of the impact on firms where they are subject to several different strands of regulatory change – often via different regulators and running in parallel. The impact on smaller and medium-sized firms can be significant – particularly where short implementation periods are applied which do not recognise business-intensive periods for certain lenders. For example, point-of-sale finance lenders having to implement changes in the final quarter of the year, in the run-up to the peak Christmas shopping period.
24. We would welcome the opportunity to discuss our proposals more fully with the Government.



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