EXPLANATORY MEMORANDUM TO

THE CONSUMER CREDIT (ENFORCEMENT, DEFAULT AND TERMINATION NOTICES) (AMENDMENT) REGULATIONS 2004

2004 No.3237

1.1 This explanatory memorandum has been prepared by the Department of Trade and Industry and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for:

- The Joint Committee on Statutory Instruments;
- The House of Lords Select Committee on the Merits of Statutory Instruments.

2. Description

2.1 The Regulations are made under sections 76(3), 88(1), 98(3) and 189(1) of the Consumer Credit Act 1974.

2.2 They are intended to come into force at the same time as an Order (the Consumer Credit Act 1974 (Electronic Communications) Order 2004) made under a power in sections 8 and 9 of the Electronic Communications Act 2004 that amends the Consumer Credit Act 1974 and a number of statutory instruments made under that Act to facilitate and enable the use of electronic communications for the making of consumer credit agreements and for the sending of notices and other documents in connection with such agreements.

2.3 Specifically, in the light of the terms of that Order, the amended Regulations make it clear that enforcement, default and termination notices served in relation to a consumer credit or hire agreement must be provided to the debtor or hirer in paper form.

3. Matters of special interest to the Joint Committee on Statutory Instruments / House of Lords Select Committee on the Merits of Statutory Instruments

3.1 None.

4. Legislative Background

4.1 These Regulations amend the existing regulations which prescribe the form and content of certain notices to be given under the Consumer Credit Act 1974 before a creditor (in the case of a credit agreement) or owner (in the case of a hire agreement) may take certain steps to enforce a regulated agreement against a debtor or hirer. The amendment expressly requires that such notices must be provided on paper as notices are generally issued to borrowers who have breached the regulated agreement (e.g. fallen behind with their repayments) or where the creditor or owner wishes to terminate the regulated agreement for reasons other than a breach. The effect of default action or termination will have a significant impact on the rights of the debtor or hirer. The likelihood that default is a result of financial hardship – and

that individuals who are experiencing such financial difficulties may no longer have access to the equipment or network access that enabled them to contract by electronic communications in the first place – makes an insistence on paper communication an essential safeguard for the rights of debtors and hirers.

4.2 The provisions on the conclusion of consumer credit agreements by electronic means are the final part of a wider package of measures that were laid on 8th June 2004, and that are designed to increase the transparency of information provided to consumers at all stages of the credit-buying process. The package also included the Consumer Credit (Advertisements) Regulations 2004; the Consumer Credit (Agreements) (Amendment) Regulations 2004; the Consumer Credit (Disclosure of Information) Regulations 2004; and the Consumer Credit (Early Settlement) Regulations 2004.

4.3 The Advertisements Regulations came into force on 31st October 2004; the remainder of the above package will come into force on 31st May 2005.

5. Extent

5.1 The Regulations extend to the whole of the United Kingdom. The responsibility for consumer credit regulation is transferred to Northern Ireland under the devolved settlement. However, as the Northern Ireland Assembly is currently suspended, the Northern Ireland Executive have been consulted, and have confirmed that the regulations be extended to Northern Ireland.

6. European Convention on Human Rights

6.1 The Parliamentary Under-secretary of State for Employment Relations, Postal Services and Consumers [Gerry Sutcliffe MP] has made the following statement regarding Human Rights:

6.2 "In my view, the provisions of the Consumer Credit (Enforcement, Default and Termination Notices) (Amendment) Regulations 2004 are compatible with the Convention rights."

7. Policy background

7.1 A major review of consumer credit law – the first since the Consumer Credit Act was introduced in 1974 – was launched in July 2001 in response to a Manifesto commitment to tackle the loan sharks. The review was characterised by an ongoing process of consultation with key stakeholders representing the credit industry, consumer groups and enforcement authorities, and culminated in the publication on 8th December 2003 of the White Paper "Fair, Clear and Competitive – the Consumer Credit Market in the 21st Century"

7.2 A consultation paper "Establishing a Transparent Market" was published alongside the White Paper. This included draft secondary legislation to give effect to the package of measures on consumer transparency – including the proposals on online agreements, and was the subject of a formal period of consultation that closed on 15th March 2004.

7.3 A total of 24 responses were received to the proposals on online agreements, and the provisions reflect comments made both in these responses and during our ongoing discussions with stakeholders. A summary of the responses to the White Paper package was published on the DTI website in June 2004. The relevant extract is attached at Annex A.

7.4 The proposed implementation date of 31st December 2004 constitutes a two-month delay over the original 31st October 2004 implementation date envisaged in the White Paper. The delay – which has been agreed with stakeholders – has permitted the clarification of a number of technical issues related to the interaction of the legal requirements and the technology that will be used to conclude agreements.

8. Impact

8.1 Lenders are already required to provide borrowers with default, enforcement and termination notices on paper. Requiring them to continue to do so – as an opt-out from the general facilitation of the use of electronic communications – will therefore impose no additional burdens on the credit industry.

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Annex A

RESPONSE TO CONSULTATION PAPER "ESTABLISHING A TRANSPARENT MARKET"

Online Agreement Regulations

140. The regulations to facilitate the transactions of consumer credit agreements electronically are hoped to be available within the next two months. As it is enabling legislation, not requiring companies to do anything but allowing them to contract by electronic means if they so choose, lenders will not be faced with compliance difficulties as a result of the limited notice so we still intend to bring the regulations into force on 31 October 2004. We aim to publish them as soon as they are agreed in-house. We aim to provide sight of Draft regulations for all stakeholders at the latest early September.

Breakdown of Responses

141. In total 24 responses were received, the breakdown of which was:

- Trade Association/bodies – 5
- Lenders – 8
- Regulatory/Supervisory bodies inc. Trading Standards – 4
- Consumer Organisations – 4
- Legal/academic – 2
- Others – 1 (companies and individuals)

Questions 35 - 36

Question 35: What additional costs will lenders incur as a result of implementing these changes to allow agreements to be concluded electronically?

142. Generally consumer consultees welcomed the proposals although it was noted that on-line transacting would bring about both costs and cost savings. It was noted that there were really no regulatory costs since companies were not to be forced to transact business in this way. Two respondees noted that important documentation (default notices etc) should be sent by hard copy mail as well. Solitary comments included that there should be a separate dispute resolution system for IT because of its frequent problems; that a license requirement should be that websites were secure and that consumers should be warned how data might be shared.

143. Business consultees generally also welcomed the proposals. There were three estimates of actual one-off costs ranging from £40,000-300,000. Three respondees suggested that lenders and consumers should be allowed to switch from IT to paper – or vice versa - during the process of contracting. One of these, plus another lender, noted that if consumers demanded to switch from a cheap IT mode of communicating to an expensive paper way, after their contract had started, then they should be charged any higher costs they caused. Solitary comments included that money laundering checks would add to the costs; that the consent indicator would be an important determinant of success for on-line; that prescribed digital signatures could

be very expensive; that attempts should be made to future proof and encompass uninvented methods and that any regulations should not be too prescriptive.

Question 36: Will costs be different for different types of businesses?

144. Few consultees responded to this question but those that did made the point that SMEs would have higher proportionate costs than larger firms.

THE CONSUMER CREDIT ACT 1974 (ELECTRONIC AGREEMENTS) ORDER 2004

REGULATORY IMPACT ASSESSMENT

1. Background:

1.1 A major review of consumer credit law - the first since the Consumer Credit Act was introduced in 1974 - was launched in July 2001 in response to a Manifesto commitment to tackle the loan sharks. The review was characterised by an ongoing process of consultation with key stakeholders representing the credit industry, consumer groups and enforcement authorities, and culminated in the publication on 8th December 2003 of the White Paper "Fair, Clear and Competitive - the Consumer Credit Market in the 21st Century"

1.2 Legislation to facilitate and enable the making of consumer credit agreements by electronic means formed a key element of the Consumer Credit Review. It was included in the package in response to general requirements in the EU Electronic Commerce Directive 2000 to encourage online commerce. A consultation document on the subject was published in December 2002; and the commitment to legislate was renewed in the Consumer Credit White Paper in December 2003.

1.3 A consultation paper "Establishing a Transparent Market" was published alongside the White Paper. This included draft secondary legislation to give effect to the package of measures on consumer transparency - and also included proposals to enable lenders and consumers to conclude consumer credit agreements by electronic

means. The consultation paper was the subject of a formal period of consultation that closed on 15th March 2004.

1.4 A total of 24 responses were received to the proposals on online agreements, and the Order reflects comments made both in these responses and during our ongoing discussions with stakeholders. A summary of the responses to the White Paper package was published on the DTI website in June 2004. The relevant extract is attached at Annex A.

1.5 Since the close of the White Paper consultation period, we have been working with key stakeholders to put this policy into practice. The result is the attached Order under section 8 of the Electronic Communications Act 2000 to amend the Consumer Credit Act 1974 (CCA) and associated secondary legislation to remove legal obstacles that currently have the effect of preventing credit agreements from being concluded or notices and documents associated with an agreement from being provided by electronic means.

1.6 Separate amendments to the Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983, under the CCA, have also been made to implement the policy objective of ensuring that certain default, enforcement and termination notices must be provided by the creditor in a paper format.

2. Chosen option:

2.1 An Order under the Electronic Communications Act 2000 to amend the Consumer Credit Act 1974 and associated secondary legislation to remove legal obstacles to enable and facilitate credit agreements to be concluded, and notices and documents to be provided, by electronic means. Further amendments to existing secondary legislation under the CCA are also required to specifically retain the requirement that certain default, enforcement and termination notices must be provided by the creditor in a paper format.

2.2 Default, enforcement and termination notices have been singled-out as a special case because they are issued to borrowers who have breached the regulated agreement (e.g. fallen behind with their repayments) or where the creditor or owner wishes to terminate the regulated agreement for reasons other than a breach. The effect of default action or termination will have a significant impact on the rights of the debtor or hirer. The likelihood that default is a result of financial hardship, and that individuals who are experiencing such financial difficulties may no longer have access to the equipment or network access that enabled them to contract by electronic communications in the first place, makes an insistence on paper communication by post an essential safeguard.

3. Impact:

3.1 Permitting lenders to offer and conclude credit agreements and provide notices and documents by electronic means will have no unavoidable cost implications - the Order is enabling, and will not require lenders who choose not to do business in the form of electronic communications to change their business practices in any way.

4. Costs:

4.1 The Order will impose no additional burdens on business over and above those already required by the Consumer Credit Act and its subordinate legislation when concluding a consumer credit agreement or sending notices or other documents.

4.2 The Order simply amends consumer credit legislation to remove impediments that currently prevent consumer credit agreements from being made or notices and other documents from being sent by electronic means. At present, many aspects of consumer credit legislation are worded in a way that envisages only paper-based agreements. Lenders must comply with these rules if their agreements are to be enforceable.

4.3 The Order has been drafted in such a way that the use of electronic communications is facilitated within the existing legal framework - the requirements for a valid consumer credit contract (however it is made) are not being changed. Consequently, lenders who choose not to offer agreements by electronic communications but continue to work on paper will not be required to change their procedures in any way. Similarly, lenders who offer credit both by use of electronic communications and by more conventional means can be confident that - although the method of communication is different - the specific regulatory requirements on the form and content of credit agreements or on the requirement to send documents necessary to conform with consumer credit legislation will be the same. The only difference will be that, when a form of electronic communication is used, both parties must agree to this.

4.4 The Order will not affect the existing statutory requirement that lenders must provide borrowers with default, enforcement or termination notices on paper. Although this is an opt-out from the general facilitation of the use of electronic communications, as a pre-existing requirement its retention will impose no additional burdens on lenders.

4.5 Ultimately, therefore, the decision of whether or not to offer agreements or to provide notices or other documents by electronic means will be a business decision for each lender.

5. Benefits:

5.1 The changes will benefit both business and consumers.

5.2 The removal of impediments to electronic contracting will open-up new markets for the credit industry – and will enable them to lend with confidence that agreements made in this way will not be held to be unenforceable on the basis of the communication medium.

5.3 Given that the internet is a relatively low-cost sales channel, we would expect it to be easier for smaller businesses, without a costly branch network, to enter this sector of the financial services market; but recognise that some very small firms may not have the technical capability to do so. However, it is likely that there will be increased competition, with an improved range of products available to consumers.

5.4 It follows that the ability to offer agreements by the use of electronic communications should result in a cut in transaction costs for lenders. For example, it will be possible for lenders to reduce the use of paper and paper storage facilities. If these savings are passed-on, consumers may therefore benefit from better deals when contracting by such methods. Such discounts are already common in other sectors, such as insurance. We recognise, however, that this might have the effect of discriminating against those groups in society – lower income groups, the less educated and the elderly – with limited or no access to the internet and other forms of electronic communication.

6. Declaration:

"I have read this Regulatory Impact Assessment, and I am satisfied that the benefits justify the cost."

Signed: *Jacqui Smith*

Jacqui Smith MP
Minister of State for Industry and the Regions, and Deputy Minister for Women and Equality
Department of Trade and Industry
8th December 2004

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8. Annexes:

Annex A: Consumer Credit White Paper "Fair, Clear and Competitive: A Consumer Credit Market for the 21st Century"; December 2003 - Regulatory Impact Assessment.

Annex B: Consultation Paper "Establishing a Transparent Market"; December 2003 - Online agreements extracts.

Annex C: Response to Consultation Paper "Establishing a Transparent Market"; December 2003 - Online agreements extracts.

Annex A

CONSUMER CREDIT WHITE PAPER – "FAIR, CLEAR AND COMPETITIVE: A CONSUMER CREDIT MARKET FOR THE 21st CENTURY"

DRAFT REGULATORY IMPACT ASSESSMENT

1. Title of Proposal

Reform of the Consumer Credit Act 1974

2. Purpose and Intended Effect

(i) The Objective

A competitive and efficient financial sector, of which the consumer credit market is an important part, is essential to raise the level of economic growth in the UK economy. Our vision is to create an efficient, fair and open market where consumers are empowered to make fully informed decisions and lenders are able to compete on a fair and even basis. This framework must also be considered in the context of wider EU commitments.

Devolution

The CCA currently applies to the whole of the UK, with certain special provisions for Northern Ireland. These do not affect the substance of the statutory regime, and the OFT exercises its responsibilities under the Act across the whole of the UK. However, consumer credit is now a devolved matter with respect to Northern Ireland, so, we are discussing with the Northern Ireland Office how these proposed changes should best be reflected there. We are also consulting with the other devolved administrations, as it is intended that the proposed reforms should apply across the whole of the UK.

(ii) The Background

The CCA was introduced in 1974. Its main objective was: 'to provide for the small individual borrower the protection he unquestionably needs without setting up artificial barriers between one sort of credit and another'. Through the licensing regime, and other targeted regulations, the Act protects borrowers in a number of ways. For example:

• It affords consumers a 'cooling-off' period, allowing the borrower to cancel the credit agreement within a certain period of time;

• A creditor cannot demand early payment, try to get the goods back, or end the agreement without, first, serving a written notice, 7 days before taking action;

• If the borrower has paid a third of the total price of the goods under a HP agreement, then the creditor cannot take the goods back without first getting a court order;

• If a credit agreement is ‘extortionate’, then the borrower can apply to the courts to ask them to look at the agreement;

• In the case where the seller of goods and the provider of credit are not the same, the borrower can make a claim against either party in the event of non-performance of the contract. For example, in the case of a faulty product, where the supplier is declared bankrupt, the borrower can make a claim against the supplier of credit;
• Certain written information must be provided to the borrower for the credit agreement to be enforceable, including the total cost of credit, the APR, and the cash-price for the goods.

Since the introduction of the Act, the credit market has been transformed – the average level of outstanding debt per person, in real terms, rising from £86, in 1969, to over £2,700, today. Thirty years ago £32m was owed on credit cards, now over £49bn is owed. The range and complexity of credit products and the sales strategies utilised by credit providers have also developed at an unprecedented rate. And the number of licences has increased by over 8,600% since the Act was introduced. The average credit card now has four different interest rates, depending upon usage, and credit is no longer simply sold on the basis of a face-to-face interview. A number of sales channels are now used, including phone, post and the internet.

Over the last two years we have reviewed the consumer credit market. Our investigations and consultations with a wide range of stakeholders have revealed problems in the consumer credit market, which the reforms outlined in this White Paper aim to address. These problems can be summarised as follows:

• **Informational problems pre purchase:** Consumers need clear consistent information to be able to make informed comparisons between the plethora of products currently available to them. Innovation and evolution in the credit market has benefited consumers
through increase choice and flexibility. However many of today’s products have become difficult for consumers to understand because they are so complex, and because there is a lack of transparency of standardised information, for example on the way the APR is calculated.

• **Undue surprises post purchase:** Often, problems arising from misinformation occur after a credit agreement has been signed and the consumer is committed. In this way, the widespread use of large early settlement fees and other hidden costs can cause under
surprises post purchase.

• **Illegal money lenders:** Illegal money lenders, who are unlicensed and operate outside the CCA, are commonly referred to as loan sharks. These loan sharks not only take advantage of vulnerable lenders but also bring disrepute to legitimate lenders.

• **Over indebtedness:** Aggregate data shows that, while the majority of consumers do not experience any difficulties with borrowing, 20% of households who have credit, experience financial difficulties, while 7% have levels of credit use associated with over indebtedness or unmanageable debt. (Household Survey (op cit 1)).

Since 2001, various focus groups have been held, comprising consumer representatives, lenders, enforcement bodies and the legal profession. These groups have assisted in the first major review of the Act since it came into force.

Throughout the period of this review, we have sought to build a consensus between all the key stakeholders. So far, we have consulted six times on different aspects of the review and have received a total of 362 responses – from consumer groups, trade associations, enforcement bodies, the legal profession and individual lenders, including sole traders.

These formal consultations have been regularly supplemented by meetings of key stakeholders, which have assisted with the development of policy in areas such as advertising and early settlement.

Full details of our consultation strategy can be found in section 10.

(iii) Risk Assessment

Informational problems can result in consumers ending up with the wrong form of credit at the wrong price. It has been estimated that consumers could save £1.9bn a year in interest payments alone by switching to cheaper credit cards.90 Assuming similar savings can be made across all unsecured borrowing, this implies an annual consumer saving of £6.1bn if consumers switched to cheaper products.

Hidden charges, large early settlement, and other post settlement surprises can result in over commitment and over expansion of the market. For example 58% of consumers who were unaware of early settlement costs said that, if they had been informed they would have gone to another lender. Hidden costs may also lead consumers into financial difficulty and over indebtedness.

Illegal moneylenders can not only take advantage of vulnerable consumers but also bring disrepute to legitimate lenders. Illegal money lenders often lock consumers into exorbitant rates of interest which can lead to escalating debt while failure to pay can lead to violence and intimidation.

The consequences of over indebtedness are often worse for the lowest income groups and can have serious repercussions, such as eviction, imprisonment, disconnection, or repossession. Overindebtedness in these groups is often linked to financial and social exclusion, and therefore has wider costs for society and the economy as a whole.

The challenge of this approach outlined in this White Paper lies in ensuring that any new regulations are able to reduce the risks to consumers posed by the current market, without unnecessarily restricting the supply of credit. The regulations will need to be flexible enough to deal with such a diverse and innovative market.

3. Options

Option 1: *Do nothing.* This option does not address any of the concerns with the current consumer credit framework.

Option 2: *Update the regulatory regime provided by the Act to improve the efficiency and fairness of the credit market.* The proposed regulatory reforms can be split into two broad categories:

A) Establishing a transparent market by refocusing regulation on:

• consumer credit advertising;

• the form and content of credit agreements;

• reducing hidden charges (such as early settlement);

• changes to pre- and post-contractual disclosure;

• ensuring the APR calculation is standardised;

• and aiding innovation by enabling agreements to be concluded online.

B) Reform of credit licensing to create a fair framework that ensures a proper balance between the needs of lenders and borrowers, by:

• providing better powers and sanctions;

• redefining 'extortionate' credit;

• encouraging responsible lending;

• enabling easier consumer redress;

• and abolishing financial limits.

The challenge of this approach lies in ensuring that any new regulations are flexible enough to deal with such a diverse and innovative market, without unnecessarily restricting the supply of credit. At the same time, these regulations must provide adequate protection for consumers.

Option 3: *Establish a voluntary code of practice that addresses the areas highlighted in Option 2.* The difficulty with this approach is that there are over 200,000 credit licence-holders in the UK, and the largest trade associations have only several hundred members. The vast majority of licence-holders are not members of any trade association. This means subscription to any voluntary code would, at best, be slow or, at worst, be minimal. It is reasonable to assume that the rogue traders these measures are designed to target would not be bound by a voluntary code of practice, anyway.

4. Benefits

Option 1: This option has no benefits over the current system, but avoids the risks of increased costs to industry and possible reduction in the supply of legal credit to the less well off associated with option 2.

Option 2: Addressing the weaknesses we have identified in the current regime will empower consumers and encourage competition in the credit market.

Increased transparency will enable market forces to operate more effectively, with both borrowers and lenders benefiting as a result. Those lenders offering the most competitive loan packages prosper, while consumers equipped with more comprehensive information will be able to make smarter choices and, ultimately, benefit from better deals.

We estimate that, in the long run, there could be a consumer saving in the region of **£381m per year**. This comprises:

• an estimated annual saving of around £306m from consumers obtaining cheaper credit products,

• a £60m per year saving on early settlement fees,

• and a £15m a year saving on consumer complaints, as a result of better informed consumers making better decisions.

Then, there are also the unquantifiable benefits, which include: reduced stress from over-indebtedness, together with reduced time off work through stress-related illness; a more effective smoothing of consumption; greater efficiency driven by fair competition; and increased consumer confidence in the market as rogue trading practices are ended.

Honest, competitive businesses will benefit from reduced costs, saving in the region of £3m per year (although, this figure does not factor-in the industry set-up and ongoing costs detailed in section 5). Clearer advertising and form and content regulations will contribute to a reduction in legal fees, while freedom to complete applications online will
help bring down administration costs.

Option 3: The consumer benefits of this option would be similar in nature to option 2. However, they would be on a smaller scale. As noted by the OFT, there is a natural limit to how tight a voluntary code can be, since tightening the code will exclude a large proportion of the market. Given that a typical voluntary code will achieve 50% sign-up, at best, we could expect 50% of the consumer benefits in option 2. However, this is probably an overestimate as legal traders likely to engage in unfair practices are unlikely to sign up to a voluntary code of conduct.

Issues of Equity and Fairness

The current system does not provide a fair deal, particularly for sub-prime borrowers who are more likely to suffer from interest rates which represent an exceptionally high risk premium, and other practices that are unfair. At present, it is very difficult for such borrowers to prove that a credit agreement is extortionate. The proposed changes to the Act will protect these consumers by removing unfair traders and better defining extortionate credit and unfair lending practices. Reforming the definition of

extortionate credit on variable-rate loans to include the interest rate in later periods, as well as the interest rate at the starting date of the agreement, is a good example of the added protection built-in by the proposed amendments. This is intended to address the problem lenders increase interest rates when the base rate increase; but do not reduce it
when the base rate falls.

The reforms proposed will increase competition by removing the possibility for unfair competition through the use of hidden pricing. At present, it is possible for traders to cross-subsidise their products by reducing the headline charge (APR) and regaining the capital on hidden costs, such as default charges, early settlement fees, late fees, administrative costs or alterations to the term.

The balance between lenders and borrowers will also be addressed, where necessary. Early settlement fees based on the rule of 78, which is always in favour of the lender, will be removed and replaced with a fair premium.

5. Costs

(i) Compliance costs

Option 1: No additional cost

Option 2:

Transitional Costs

Costs for lenders making the transition to the new regulatory framework are estimated to be in the region of £127m. These costs reflect the regulatory reforms as set out in Chapters 2 and three.

These costs consist of IT development and installation, management time, staff training, legal advice (in re-designing contracts), administration costs and increased business risk.

Reforms to the way in which early settlement fees are calculated require businesses to make substantial changes to IT systems. There are also IT costs involved in redrafting the form and content of agreements. In addition, there will, inevitably, be IT costs for those lenders that choose to sell credit products online (in response to the reform to regulations
governing online transactions).

General business risk will increase as consumers are empowered through a more effective means of redress, such as the ADR. This empowerment will lead to an initial increased cost to business as current practices are challenged. However, as rogue traders are forced out of the market and problematic practices are eradicated, we would expect the ongoing cost to business to fall. We estimate increased business risk to total £8 million in the first year after the reforms. This represents the cost to lenders of higher consumer complaints than anticipated in the ADR running costs. The

transitional business risk is a third higher than the ongoing business risk, to reflect an initial surge in complaints once the service
becomes available.

Training staff to use new systems will also impose a substantial transitional cost to business. However, this cost may be mitigated by lenders' staff turnover and ongoing training strategies.

These transitional costs will be mitigated by:

• Allowing lenders a period of preparation and adjustment before implementation is required. (The regulatory reforms of the CCA, as set out in this White Paper, will not come into effect before October 2004. The reforms that require primary legislation will be implemented significantly later.)

• Making the framework as flexible as possible (for example, the removal of the financial limits exemption, will remove the necessity for continual updating of the limit, which has increased from £5,000 to £25,000 since its introduction).

• Simultaneously introducing reforms on transparency (advertising, form and content, online agreements and early settlement), in October 2004, which means lenders will be able to make all the system changes and updates required, in one hit.

• The continued provision of clear guidance by the OFT to enable lenders to adapt to the new framework with minimal disruption.

Compliance Costs

The ongoing impact of the proposed changes to lenders' costs is estimated at £84.4m per year.

The compliance cost, estimated above, results from the licensing fee; introduction of the ADR system; increases in cases going through the ADR system; increased business risk; reduced revenue from early settlement fees; and administration costs from issuing regular statements and possibly dealing with an increased number of early settlements.

The new licensing regime will impose two costs on lenders: the direct cost of the licensing fee and, the indirect cost of complying with these powers. These are the same costs imposed on businesses by the existing licensing regime. The targeted nature of the new regime will need further calculation of the costs specific to different categories of business, and this will be a part of the planned consultation.

We estimate that the ADR system will cost £10m per annum, this is a conservative estimate, and will be reviewed in the forthcoming consultation. Increases in business risk owing to the ADR provision are expected to fall to £6m annually, after the initial transition. There will also be some increase in business risk by allowing the completion of agreements online (through increased exposure to fraud, such as, identity theft – i.e. applying for credit products in someone else's name).

Changes in the calculation of the early settlement fees will reduce business revenue by £60m a year.

Administration costs are expected to total £4.9m, annually.

Option 3:

The transitional and compliance costs of this option would be as option 2, but would only be borne by those lenders who have signed-up to the voluntary code. Assuming a 50% take-up, transitional costs are expected to total £63.5m, and compliance costs are expected to total around £42m. However, there would also be an additional cost of advertising the code of conduct. Ongoing advertising in the press and on radio would be around £500,000 a year.

(ii) Other Costs

We expect that this set of measures will have a negligible impact outside of the credit market. We do not envisage these changes impacting upon the size of the credit market, but do expect the composition of the market to change.

(iii) Costs for a Typical Business

Three types of lenders exist in this market – large lenders, SMEs which are members of a trade association, and SMEs that are not.

The regulation reforms should have a small impact on the costs of larger lenders because these lenders are routinely redrafting and re-printing material, and training staff. They also are likely to have legal and IT staff in-house, and can also recoup these costs more quickly. With an adequate transition period, their additional costs will be very small.

SME lenders who are part of a trade body have greater access to centrally provided advice. This will aid any transition and keep costs relatively low.

We acknowledge that transitional costs may disproportionately fall on SMEs without access to trade association resources. However, we do not envisage that SMEs will find these one-off costs unaffordable or that these costs will place them at any significant competitive disadvantage.
The costs vary substantially between activities. Costs for traders using licences solely for credit brokerage (the most common activity for licence-holders, constituting around 40% of all credit licence-holders) will only increase by the increased licence fee, though those advertising loans may incur some of the costs associated with the advertising regulations. Only licence-holders who engage directly in lending will face the full cost of the reforms.

Breakdown of estimated transitional and compliance costs

Transitional	**Costs**
Business risk	£8m

Staff training	£29.8m
IT	£54.3m
Management time	£9.3m
Legal costs	£11m
Administration costs	£14.7m
Total transitional costs	**£127.1m**
Compliance	
Business risk	£9.5m
Early settlement	£60m annually
ADR	£10m
Administration costs	£4.9m
Licensing fees	To be confirmed
Total compliance costs	**£84.4m**
TOTAL COSTS	**£211.5m**

Breakdown of Cost by Firm

TRANSITIONAL	**Small**	**Medium**	**Large**
Business risk	482	588	888
Staff training	1,797	2,190	3,308
IT	3,274	3,990	6,028
Management time	561	683	1,032
Legal Costs	663	808	1,221
Administration costs	886	1080	1,632
Total	**7,663**	**9,340**	**14,110**
COMPLIANCE			
Business risk	573	698	1,055
Early Settlement	3,617	4,409	6,661
ADR	603	735	1,110
Administration costs	295	360	544
Total	**5,089**	**6,202**	**9,370**

Assumed that 25% of lenders are small, 30% are medium-size, and 45% are large

Risk Assessment

The risks of each individual policy measure are considered in more detail in the respective chapter of the White Paper and in the Regulatory Impact Assessments in the consultation on draft regulations on form and content, online agreements, advertising and early settlement which can be found at the end of this document.

There is a risk that the cumulative effect of the measures proposed in the White Paper could be that the cost of credit rises, especially in the sub prime market. This, in turn,

could make the credit business for small lenders unprofitable and drive them out of the market.

However, collectively, we think this package of policy measures will increase consumer confidence in the entire credit market, including the sub-prime sector. The spur to competition that this generates should allow the more competitive and innovative firms (both small and large) to gain market share, while less competitive lenders are forced out. This will provide benefits to the consumer through lower prices, higher quality, more innovation, as well as giving them the confidence that they are making like-for-like comparisons between products.

There is a small risk that a vacuum will still remain in the sub-prime market, however, there are already signs that larger credit businesses currently operating in the prime market, may branch into the sub-prime sector. A more credible risk is that the reforms increase the cost of lending to the sub-prime market, reflecting the uncertainty of an increased number of challenges to unfair agreements, combined with an already higher-risk premium. However, this should be mitigated over time as case law is developed, providing the average borrower in the sub prime market with better and fairer agreements, as transparency allows the vacuum to be filled by fairer lenders, and alternate sources of credit such as credit unions, COFIs and other social lenders.

The most difficult issue surrounds extortionate credit provision. The issue of whether these measures restrict credit or not, lies within the nature of the test. If the new test would focus unduly on the cost of credit, this could introduce a de-facto rate ceiling. This, in turn, may have a particular effect on the sub-prime market. However we will bear this risk in mind and aim to avoid it when formulating the legislative factors and guidance to define unfair credit transactions to ensure a balance is struck between capturing unfair practices and not placing onerous burdens on the lender.

6. Consultation with Small Business: the Small Firms' Impact Test

Throughout the period of the review we have engaged with key trade associations whose membership predominantly comprises small businesses. We have also met with the owners of small lending businesses from southern Scotland, north Wales, the north west of England, Swindon, Hull and London. In addition, we have obtained advice from businesses that lend extensively to small businesses in sectors, such as, construction, and from businesses that act as consultants to a variety of small businesses inside and outside of the lending community.

On the basis of this, we have concluded that the reforms do not have a disproportionate impact on small business nor will it restrict the ability of small businesses to obtain credit.

7. Competition Assessment

The impact of the proposals on the consumer credit market was assessed in relation to the consultation responses, and was found to be unlikely to raise concerns about competition. In fact, we consider the proposals to be generally pro-competitive as transparency, certainty, and fairness in the market increases. Any change in the

composition of the official lending market will be the result of competitive forces, but will affect small,
medium and large firms equally. While smaller firms could incur slightly higher costs in some instances, we expect this to be offset by the benefits in terms of a more transparent, competitive market, with some consumers feeling more confident in approaching smaller lenders as a consequence.

We acknowledge that the transitional and compliance costs of these reforms will place a burden on all lenders. In particular, there is a small risk that this may raise barriers to entry into the market, particularly for small lenders. However, we believe that the compliance costs will be small relative to the vast sums incurred in successful entry into the market in terms of infrastructure, IT, skills, marketing etc and should not therefore represent a significant barrier to entry. At the same time, there are likely to be significant benefits as rogue traders are eradicated from the market and their market share is spread among the fair and honest lenders.

8. Enforcement and Sanctions

While we are proposing significant reform of the regulatory regime, we do not envisage any changes to the existing enforcement arrangements which include criminal and civil sanctions, statutory powers available to the court in relation to the enforceability of agreements, and powers bestowed upon the OFT in relation to advertising for which local authority trading standards departments (TSDs) have day to day authority.

The proposals on licensing will enable the OFT to take sanctions against lenders in a wider range of cases and will, therefore, lead to a larger number of appeals against these determinations. It is predicted, however, that after an initial peak, the number of cases should fall back to their current level as lenders' standards increase. Experience from the FSA shows that businesses raised their game before the introduction of new regulations.

The proposals on extortionate credit are designed to make it easier for the courts to intervene where borrowers are being exploited. It has therefore been estimated that the number of complaints and court cases will increase as the new system is implemented.

We have indicated that we intend to introduce an Alternative Dispute Resolution ('ADR') process for consumers seeking redress. This will provide consumers with an additional form of redress.

The recent DTI survey showed that people are generally unwilling to go through the court process, but would be more willing to challenge the terms of an agreement through some alternative route, such as a third-party intermediary or a financial ombudsman. Therefore, it is anticipated that the number of cases dealing with extortionate credit may increase. However, it is envisaged that these cases should be resolved at no cost to the consumer, although the costs to lenders and traders will increase on the assumption the number of cases increases compared with the number that currently go to court.

9. Monitoring and Review

The Government is committed to conduct a review within three years of any regulatory changes it introduces, utilizing the success measures outlined in Annex A.

10. Consultation

(i) Within Government

We have consulted the OFT, HM Treasury, the Cabinet Office, DCA, devolved administrations, Number 10, the Social Exclusion Unit, DWP, DfES and FCO.

(ii) Public Consultation

The review has been overseen by a board chaired by DTI and comprising representatives from:

• The Citizens Advice Bureau – to provide an understanding of the difficulties experienced by consumers;

• The Finance and Leasing Association – who represent a wide range of lenders;

• The Office of Fair Trading – to provide an overview of the role of the enforcement authorities; and

• An academic lawyer—to ensure that our work takes account of wider legal implications.

We have undertaken six formal consultation exercises:
• July 2001: an overview of the CCA and priorities for reform entitled: Tackling the loan sharks. We received 107 responses to this consultation.

• March 2002: increasing or removing the £25,000 financial limit in the CCA and reviewing the status of some exempt agreements, to which we received 55 responses.

• August 2002: making the regulations on early settlement fair and equitable to both lenders and borrowers, to which we received 38 responses.

• December 2002: we received 35 responses to a consultation paper on enabling lenders and consumers to be able to enter into and conclude credit agreements by electronic means.

• January 2003: we consulted on the reform of the consumer credit licensing regime and received 57 responses.

• March 2003: we received 70 responses to our consultation on the reform of the protections offered to consumers in respect of extortionate credit.

Each of these consultation papers has been issued for a minimum of twelve weeks and has been sent to interested parties, as well as being available electronically on the DTI website.

These formal consultations have been supplemented by a series of meetings with key stakeholders to generate proposals in areas, such as, advertising and the form and content of agreements, and understanding the wider impact of the proposals on lenders. We have also consulted with the FSA, a statutory regulator, and have other consultations planned for the future, as outlined in chapter 6.

Our understanding of the credit market has been supplemented by independent research on:

• Extortionate credit in the UK

• The US credit market

• The Cause, Extent and Effects of Over-indebtedness

• Consumer Credit Awareness survey

Wider social concerns about the rise in levels of consumer debt have been addressed by the Taskforce on Tackling Over-indebtedness, which was set up in October 2000. Its remit was to address concerns about consumer debt in the UK by considering ways of achieving more responsible lending and borrowing. It has reported twice to Ministers and
many of their recommendations have been incorporated in this proposal.

Several members of the team have been seconded from major lenders to provide a detailed insight into how regulations are viewed and interpreted. Finally, members of the Civil Service have spent short periods shadowing staff of various lenders to gain a firsthand understanding of the way different sectors within the financial industry are involved in consumer credit.

11. Summary and recommendation

Option	Total cost per annum	Total benefit per annum
1	No additional cost over the current system. Consumer detriment will continue and fair lenders will continue to lose out to unscrupulous lenders.	
2	**Increase in ongoing costs estimated as £84.4m, of which:** Reduced revenues to lenders from excessive early settlement fees of £60m. Business risk: £6m to allow for the	**Total benefits of £384m, of which:** Consumers benefit from a direct reduction in unfair settlement fees of £60m. We also estimate that consumers

	increased risk of being challenged over agreements or practices through the ADR, and £3m for identity fraud, if companies opt for online completion. ADR system cost of £10m Administration costs of £4.9m include more frequent statements. Implementation costs of new regulations: £127.1m of which: IT costs £54.3m, the majority is allocated to early settlement system changes, with the remainder going on form and content and online contractual changes. Staff training: £29.8m Administration: £14.7m Approximately £10m allocated to both legal costs and management time. £8m in business risk has been allocated to account for the initial surge in demand for ADR.	will derive £306m in benefit through switching to more suitable loans. Greater competition will bring improvements in price, choice, quality, and innovation. This will benefit both consumers and lenders, with most competitive lenders gaining market share. Businesses will also derive benefit in the region of £15m from fewer consumer complaints, and £3m from lower compliance costs as a result of clearer legislation.
3	Based on our assumption of a maximum 50% sign-up rate to voluntary codes of conduct, we estimate the costs to be half those of the above option, and quite possibly less, because, as already mentioned above, the requirements will be less strict.	At best we can expect 50% of the benefits under option 2.

12. Recommendation

It is considered that Option 2 would promote competition, a consistent and fairer deal for consumers and business, and allow confidence in the credit market to grow. These benefits, when considered together, provide a transparent, fair and adaptable framework that will allow the credit market to continue to develop and innovate. Option 2 is consistent with Government objectives to promote competition and empower consumers, while still providing protection for vulnerable groups. This

option is expected to promote efficiency and allow savings for business, consumers and Government in the longer term.

Annex B

CONSULTATION PAPER "ESTABLISHING A TRANSPARENT MARKET"

ON-LINE AGREEMENTS

The Internet has become an important means for many consumers of purchasing goods and services.

The Consumer Credit Act 1974 was conceived with paper in mind and there is at present no clear provision in the Act or Regulations for facilitating or regulating the conclusion of electronic contracts.

The Consultation issued in December 2002, identified four main issues upon which we sought views and below we have set out our policy proposals in each respect.

The results of the consultation will be summarised on our website on the 15 December 2003 but the main ones were:

• strong support for a single regime covering the Electronic Commerce Directive (ECD) and Distance Marketing of Consumer Financial Services Directive (DMD) requirements;

• widespread agreement that concluding an agreement on-line did not necessarily require one particular form of digital signature;

• Pressure for developing regulations that are as 'future proof' as possible; and

• General agreement that important documents, such as default notices, should be sent by post.

Proposals

1. The decision to contract electronically

We want to make it possible, but not mandatory, to contract electronically. The decision for both the lender and consumer as to whether to choose this medium raises a number of issues, such as whether they are able to do so technically, whether they have consented to doing so, and the reliability of the communications.

General Legibility Requirement

A general legibility requirement set out within the Agreements Regulations will be retained as it is generally accepted that prescribing a minimum font size will not necessarily be appropriate for text on a computer screen (as this can be altered by the reader, depending upon the equipment they are using).

Record Keeping

In accordance with the requirements of both the ECD and also the DMD (from which the ‘durable medium’ requirement stems) we will introduce a requirement for consumers transacting on-line to receive in a form which can be stored in a ‘durable medium’ copies of the documentation received from the lender.

We will not impose a requirement upon the lender to determine, in advance of agreeing to contract electronically, whether the consumer has the capability to be able to store and reproduce them electronically.

Post Agreement Communications

Important Communications:

The current provisions under the Act require that paper copies of various notices/documents be provided to consumers at various times during the application process, and during the lifetime of the agreement, for example cancellation notices and default notices.

From the consultation responses we received, we consider that two of the notices (default and cancellation) are of sufficient importance that they should not simply be sent by electronic means. The consequences of failing to read and act on these documents can be particularly severe for the consumer. As postal communications are much more difficult to overlook or to destroy accidentally than electronic communications, we believe that it is necessary for the protection of consumers to continue to require these documents to be sent to consumers on paper. However, we will not preclude lenders sending both an electronic and paper version if they wish.

Other Communications:

Otherwise, we propose that the medium for the conclusion of the contract should determine the way in which the notices should be delivered to the consumer. Therefore, as a general rule, where a consumer agrees to conclude a credit agreement electronically, any future communication should also be by electronic means. It will, however, be possible for lenders/consumers to amend the means of communication. We do not propose to prevent a lender from charging a ‘reasonable’ fee, should the change in method of communicating with the consumer be at the request of the consumer and be more costly to the lender.

Deemed Receipt:

We are considering whether we should provide for deemed receipt after a certain period from transmission. We are minded to adopt an approach where, for example, delivery is deemed to have been effected at the end of 48 hours after the time at which the electronic communication is sent.

2. The Form of a Credit Agreement

Legislative references to writing may include electronic writing but this obviously does not apply where the context makes clear that Parliament intended to limit the methods of communication to paper-based methods only.

We are concurrently making changes to the Consumer Credit (Agreements) Regulations 1983 which will apply equally to paper as to electronic transactions. This will ensure that we achieve a technology neutral approach and the prescribed information and layout of agreements will be the same regardless of the method of contracting.

We have determined that one of the areas we need to address specifically is the provisions within the Agreements Regulations which refer to colour of paper.

3. Signature Requirements

We have concluded that it is not appropriate to require one particular form of digital signature for on-line agreements. Regulations will set out how the consumer's consent is to be indicated in on-line agreements.

Provision for an indication of consent would create a specific distinction between paper and electronic based transactions when considering the signature requirements. We are of the view that where a contract is concluded in a paper format, we will retain the requirement that a signature will be necessary to evidence consent to enter into the agreement.

4. Copies and Cancellation

Copies of Documents

We intend to introduce a requirement allowing copies of documents to be provided by electronic means, including the final, executed copy of the agreement provided the consumer has agreed with the lender that they will communicate using electronic means. However, the lender needs to ensure that the copy retained by him is capable of being stored in a durable medium so that it can be reproduced at any time.

As is currently provided for under the Act, consumers will be able, upon payment of a prescribed fee, to request a copy of the executed agreement at any time during the course of the agreement.

Question 35: What additional costs will lenders incur as a result of implementing these changes to allow agreements to be concluded electronically?

Question 36: Will costs be different for different types of businesses?

Annex C

RESPONSE TO CONSULTATION PAPER "ESTABLISHING A TRANSPARENT MARKET"

Online Agreement Regulations

140. The regulations to facilitate the transactions of consumer credit agreements electronically are hoped to be available within the next two months. As it is enabling legislation, not requiring companies to do anything but allowing them to contract by electronic means if they so choose, lenders will not be faced with compliance difficulties as a result of the limited notice so we still intend to bring the regulations into force on 31 October 2004. We aim to publish them as soon as they are agreed in-house. We aim to provide sight of Draft regulations for all stakeholders at the latest early September.

Breakdown of Responses

141. In total 24 responses were received, the breakdown of which was:

- Trade Association/bodies – 5
- Lenders – 8
- Regulatory/Supervisory bodies inc. Trading Standards – 4
- Consumer Organisations – 4
- Legal/academic – 2
- Others – 1 (companies and individuals)

Questions 35 - 36

Question 35: What additional costs will lenders incur as a result of implementing these changes to allow agreements to be concluded electronically?

142. Generally consumer consultees welcomed the proposals although it was noted that on-line transacting would bring about both costs and cost savings. It was noted that there were really no regulatory costs since companies were not to be forced to transact business in this way. Two respondees noted that important documentation (default notices etc) should be sent by hard copy mail as well. Solitary comments included that there should be a separate dispute resolution system for IT because of its frequent problems; that a license requirement should be that websites were secure and that consumers should be warned how data might be shared.

143. Business consultees generally also welcomed the proposals. There were three estimates of actual one-off costs ranging from £40,000-300,000. Three respondees suggested that lenders and consumers should be allowed to switch from IT to paper – or vice versa - during the process of contracting. One of these, plus another lender, noted that if consumers demanded to switch from a cheap IT mode of communicating to an expensive paper way, after their contract had started, then they should be charged any higher costs they caused. Solitary comments included that money laundering checks would add to the costs; that the consent indicator would be an important determinant of success for on-line; that prescribed digital signatures could

be very expensive; that attempts should be made to future proof and encompass uninvented methods and that any regulations should not be too prescriptive.

Question 36: Will costs be different for different types of businesses?

144. Few consultees responded to this question but those that did made the point that SMEs would have higher proportionate costs than larger firms.

THE CONSUMER CREDIT ACT 1974 (ELECTRONIC AGREEMENTS) ORDER 2004

REGULATORY IMPACT ASSESSMENT

1. Background:

1.1 A major review of consumer credit law - the first since the Consumer Credit Act was introduced in 1974 - was launched in July 2001 in response to a Manifesto commitment to tackle the loan sharks. The review was characterised by an ongoing process of consultation with key stakeholders representing the credit industry, consumer groups and enforcement authorities, and culminated in the publication on 8th December 2003 of the White Paper "Fair, Clear and Competitive - the Consumer Credit Market in the 21st Century"

1.2 Legislation to facilitate and enable the making of consumer credit agreements by electronic means formed a key element of the Consumer Credit Review. It was included in the package in response to general requirements in the EU Electronic Commerce Directive 2000 to encourage online commerce. A consultation document on the subject was published in December 2002; and the commitment to legislate was renewed in the Consumer Credit White Paper in December 2003.

1.3 A consultation paper "Establishing a Transparent Market" was published alongside the White Paper. This included draft secondary legislation to give effect to the package of measures on consumer transparency - and also included proposals to enable lenders and consumers to conclude consumer credit agreements by electronic means. The consultation paper was the subject of a formal period of consultation that closed on 15th March 2004.

1.4 A total of 24 responses were received to the proposals on online agreements, and the Order reflects comments made both in these responses and during our ongoing discussions with stakeholders. A summary of the responses to the White Paper package was published on the DTI website in June 2004. The relevant extract is attached at Annex A.

1.5 Since the close of the White Paper consultation period, we have been working with key stakeholders to put this policy into practice. The result is the attached Order under section 8 of the Electronic Communications Act 2000 to amend the Consumer Credit Act 1974 (CCA) and associated secondary legislation to remove legal obstacles that currently have the effect of preventing credit agreements from being concluded or notices and documents associated with an agreement from being provided by electronic means.

1.6 Separate amendments to the Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983, under the CCA, have also been made to implement the policy objective of ensuring that certain default, enforcement and termination notices must be provided by the creditor in a paper format.

2. Chosen option:

2.1 An Order under the Electronic Communications Act 2000 to amend the Consumer Credit Act 1974 and associated secondary legislation to remove legal obstacles to enable and facilitate credit agreements to be concluded, and notices and documents to be provided, by electronic means. Further amendments to existing secondary legislation under the CCA are also required to specifically retain the requirement that certain default, enforcement and termination notices must be provided by the creditor in a paper format.

2.2 Default, enforcement and termination notices have been singled-out as a special case because they are issued to borrowers who have breached the regulated agreement (e.g. fallen behind with their repayments) or where the creditor or owner wishes to terminate the regulated agreement for reasons other than a breach. The effect of default action or termination will have a significant impact on the rights of the debtor or hirer. The likelihood that default is a result of financial hardship, and that individuals who are experiencing such financial difficulties may no longer have access to the equipment or network access that enabled them to contract by electronic communications in the first place, makes an insistence on paper communication by post an essential safeguard.

3. Impact:

3.1 Permitting lenders to offer and conclude credit agreements and provide notices and documents by electronic means will have no unavoidable cost implications - the Order is enabling, and will not require lenders who choose not to do business in the form of electronic communications to change their business practices in any way.

4. Costs:

4.1 The Order will impose no additional burdens on business over and above those already required by the Consumer Credit Act and its subordinate legislation when concluding a consumer credit agreement or sending notices or other documents.

4.2 The Order simply amends consumer credit legislation to remove impediments that currently prevent consumer credit agreements from being made or notices and other documents from being sent by electronic means. At present, many aspects of consumer credit legislation are worded in a way that envisages only paper-based agreements. Lenders must comply with these rules if their agreements are to be enforceable.

4.3 The Order has been drafted in such a way that the use of electronic communications is facilitated within the existing legal framework - the requirements for a valid consumer credit contract (however it is made) are not being changed. Consequently, lenders who choose not to offer agreements by electronic communications but continue to work on paper will not be required to change their procedures in any way. Similarly, lenders who offer credit both by use of electronic communications and by more conventional means can be confident that - although the method of communication is different - the specific regulatory requirements on the form and content of credit agreements or on the requirement to send documents necessary to conform with consumer credit legislation will be the same. The only

difference will be that, when a form of electronic communication is used, both parties must agree to this.

4.4 The Order will not affect the existing statutory requirement that lenders must provide borrowers with default, enforcement or termination notices on paper. Although this is an opt-out from the general facilitation of the use of electronic communications, as a pre-existing requirement its retention will impose no additional burdens on lenders.

4.5 Ultimately, therefore, the decision of whether or not to offer agreements or to provide notices or other documents by electronic means will be a business decision for each lender.

5. Benefits:

5.1 The changes will benefit both business and consumers.

5.2 The removal of impediments to electronic contracting will open-up new markets for the credit industry – and will enable them to lend with confidence that agreements made in this way will not be held to be unenforceable on the basis of the communication medium.

5.3 Given that the internet is a relatively low-cost sales channel, we would expect it to be easier for smaller businesses, without a costly branch network, to enter this sector of the financial services market; but recognise that some very small firms may not have the technical capability to do so. However, it is likely that there will be increased competition, with an improved range of products available to consumers.

5.4 It follows that the ability to offer agreements by the use of electronic communications should result in a cut in transaction costs for lenders. For example, it will be possible for lenders to reduce the use of paper and paper storage facilities. If these savings are passed-on, consumers may therefore benefit from better deals when contracting by such methods. Such discounts are already common in other sectors, such as insurance. We recognise, however, that this might have the effect of discriminating against those groups in society – lower income groups, the less educated and the elderly – with limited or no access to the internet and other forms of electronic communication.

6. Declaration:

"I have read this Regulatory Impact Assessment, and I am satisfied that the benefits justify the cost."

Signed:

Jacqui Smith MP
Minister of State for Industry and the Regions, and Deputy Minister for Women and Equality
Department of Trade and Industry
6th December 2004

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8. Annexes:

Annex A: Consumer Credit White Paper "Fair, Clear and Competitive: A Consumer Credit Market for the 21st Century"; December 2003 - Regulatory Impact Assessment.

Annex B: Consultation Paper "Establishing a Transparent Market"; December 2003 - Online agreements extracts.

Annex C: Response to Consultation Paper "Establishing a Transparent Market"; December 2003 - Online agreements extracts.

Annex A

CONSUMER CREDIT WHITE PAPER – "FAIR, CLEAR AND COMPETITIVE: A CONSUMER CREDIT MARKET FOR THE 21st CENTURY"

DRAFT REGULATORY IMPACT ASSESSMENT

1. Title of Proposal

Reform of the Consumer Credit Act 1974

2. Purpose and Intended Effect

(i) The Objective

A competitive and efficient financial sector, of which the consumer credit market is an important part, is essential to raise the level of economic growth in the UK economy. Our vision is to create an efficient, fair and open market where consumers are empowered to make fully informed decisions and lenders are able to compete on a fair and even basis. This framework must also be considered in the context of wider EU commitments.

Devolution

The CCA currently applies to the whole of the UK, with certain special provisions for Northern Ireland. These do not affect the substance of the statutory regime, and the OFT exercises its responsibilities under the Act across the whole of the UK. However, consumer credit is now a devolved matter with respect to Northern Ireland, so, we are discussing with the Northern Ireland Office how these proposed changes should best be reflected there. We are also consulting with the other devolved administrations, as it is intended that the proposed reforms should apply across the whole of the UK.

(ii) The Background

The CCA was introduced in 1974. Its main objective was: 'to provide for the small individual borrower the protection he unquestionably needs without setting up artificial barriers between one sort of credit and another'. Through the licensing regime, and other targeted regulations, the Act protects borrowers in a number of ways. For example:

• It affords consumers a 'cooling-off' period, allowing the borrower to cancel the credit agreement within a certain period of time;

• A creditor cannot demand early payment, try to get the goods back, or end the agreement without, first, serving a written notice, 7 days before taking action;

• If the borrower has paid a third of the total price of the goods under a HP agreement, then the creditor cannot take the goods back without first getting a court order;

• If a credit agreement is ‘extortionate’, then the borrower can apply to the courts to ask them to look at the agreement;

• In the case where the seller of goods and the provider of credit are not the same, the borrower can make a claim against either party in the event of non-performance of the contract. For example, in the case of a faulty product, where the supplier is declared bankrupt, the borrower can make a claim against the supplier of credit;
• Certain written information must be provided to the borrower for the credit agreement to be enforceable, including the total cost of credit, the APR, and the cash-price for the goods.

Since the introduction of the Act, the credit market has been transformed – the average level of outstanding debt per person, in real terms, rising from £86, in 1969, to over £2,700, today. Thirty years ago £32m was owed on credit cards, now over £49bn is owed. The range and complexity of credit products and the sales strategies utilised by credit providers have also developed at an unprecedented rate. And the number of licences has increased by over 8,600% since the Act was introduced. The average credit card now has four different interest rates, depending upon usage, and credit is no longer simply sold on the basis of a face-to-face interview. A number of sales channels are now used, including phone, post and the internet.

Over the last two years we have reviewed the consumer credit market. Our investigations and consultations with a wide range of stakeholders have revealed problems in the consumer credit market, which the reforms outlined in this White Paper aim to address. These problems can be summarised as follows:

• **Informational problems pre purchase:** Consumers need clear consistent information to be able to make informed comparisons between the plethora of products currently available to them. Innovation and evolution in the credit market has benefited consumers
through increase choice and flexibility. However many of today’s products have become difficult for consumers to understand because they are so complex, and because there is a lack of transparency of standardised information, for example on the way the APR is calculated.

• **Undue surprises post purchase:** Often, problems arising from misinformation occur after a credit agreement has been signed and the consumer is committed. In this way, the widespread use of large early settlement fees and other hidden costs can cause under
surprises post purchase.

• **Illegal money lenders:** Illegal money lenders, who are unlicensed and operate outside the CCA, are commonly referred to as loan sharks. These loan sharks not only take advantage of vulnerable lenders but also bring disrepute to legitimate lenders.

• **Over indebtedness:** Aggregate data shows that, while the majority of consumers do not experience any difficulties with borrowing, 20% of households who have credit, experience financial difficulties, while 7% have levels of credit use associated with over indebtedness or unmanageable debt. (Household Survey (op cit 1)).

Since 2001, various focus groups have been held, comprising consumer representatives, lenders, enforcement bodies and the legal profession. These groups have assisted in the first major review of the Act since it came into force.

Throughout the period of this review, we have sought to build a consensus between all the key stakeholders. So far, we have consulted six times on different aspects of the review and have received a total of 362 responses – from consumer groups, trade associations, enforcement bodies, the legal profession and individual lenders, including sole traders.

These formal consultations have been regularly supplemented by meetings of key stakeholders, which have assisted with the development of policy in areas such as advertising and early settlement.

Full details of our consultation strategy can be found in section 10.

(iii) Risk Assessment

Informational problems can result in consumers ending up with the wrong form of credit at the wrong price. It has been estimated that consumers could save £1.9bn a year in interest payments alone by switching to cheaper credit cards.90 Assuming similar savings can be made across all unsecured borrowing, this implies an annual consumer saving of £6.1bn if consumers switched to cheaper products.

Hidden charges, large early settlement, and other post settlement surprises can result in over commitment and over expansion of the market. For example 58% of consumers who were unaware of early settlement costs said that, if they had been informed they would have gone to another lender. Hidden costs may also lead consumers into financial difficulty and over indebtedness.

Illegal moneylenders can not only take advantage of vulnerable consumers but also bring disrepute to legitimate lenders. Illegal money lenders often lock consumers into exorbitant rates of interest which can lead to escalating debt while failure to pay can lead to violence and intimidation.

The consequences of over indebtedness are often worse for the lowest income groups and can have serious repercussions, such as eviction, imprisonment, disconnection, or repossession. Overindebtedness in these groups is often linked to financial and social exclusion, and therefore has wider costs for society and the economy as a whole.

The challenge of this approach outlined in this White Paper lies in ensuring that any new regulations are able to reduce the risks to consumers posed by the current market, without unnecessarily restricting the supply of credit. The regulations will need to be flexible enough to deal with such a diverse and innovative market.

3. Options

Option 1: *Do nothing.* This option does not address any of the concerns with the current consumer credit framework.

Option 2: *Update the regulatory regime provided by the Act to improve the efficiency and fairness of the credit market.* The proposed regulatory reforms can be split into two broad categories:

A) Establishing a transparent market by refocusing regulation on:

• consumer credit advertising;

• the form and content of credit agreements;

• reducing hidden charges (such as early settlement);

• changes to pre- and post-contractual disclosure;

• ensuring the APR calculation is standardised;

• and aiding innovation by enabling agreements to be concluded online.

B) Reform of credit licensing to create a fair framework that ensures a proper balance between the needs of lenders and borrowers, by:

• providing better powers and sanctions;

• redefining 'extortionate' credit;

• encouraging responsible lending;

• enabling easier consumer redress;

• and abolishing financial limits.

The challenge of this approach lies in ensuring that any new regulations are flexible enough to deal with such a diverse and innovative market, without unnecessarily restricting the supply of credit. At the same time, these regulations must provide adequate protection for consumers.

Option 3: *Establish a voluntary code of practice that addresses the areas highlighted in Option 2.* The difficulty with this approach is that there are over 200,000 credit licence-holders in the UK, and the largest trade associations have only several hundred members. The vast majority of licence-holders are not members of any trade association. This means subscription to any voluntary code would, at best, be slow or, at worst, be minimal. It is reasonable to assume that the rogue traders these measures are designed to target would not be bound by a voluntary code of practice, anyway.

4. Benefits

Option 1: This option has no benefits over the current system, but avoids the risks of increased costs to industry and possible reduction in the supply of legal credit to the less well off associated with option 2.

Option 2: Addressing the weaknesses we have identified in the current regime will empower consumers and encourage competition in the credit market.

Increased transparency will enable market forces to operate more effectively, with both borrowers and lenders benefiting as a result. Those lenders offering the most competitive loan packages prosper, while consumers equipped with more comprehensive information will be able to make smarter choices and, ultimately, benefit from better deals.

We estimate that, in the long run, there could be a consumer saving in the region of **£381m per year**. This comprises:

• an estimated annual saving of around £306m from consumers obtaining cheaper credit products,

• a £60m per year saving on early settlement fees,

• and a £15m a year saving on consumer complaints, as a result of better informed consumers making better decisions.

Then, there are also the unquantifiable benefits, which include: reduced stress from over-indebtedness, together with reduced time off work through stress-related illness; a more effective smoothing of consumption; greater efficiency driven by fair competition; and increased consumer confidence in the market as rogue trading practices are ended.

Honest, competitive businesses will benefit from reduced costs, saving in the region of £3m per year (although, this figure does not factor-in the industry set-up and ongoing costs detailed in section 5). Clearer advertising and form and content regulations will contribute to a reduction in legal fees, while freedom to complete applications online will
help bring down administration costs.

Option 3: The consumer benefits of this option would be similar in nature to option 2. However, they would be on a smaller scale. As noted by the OFT, there is a natural limit to how tight a voluntary code can be, since tightening the code will exclude a large proportion of the market. Given that a typical voluntary code will achieve 50% sign-up, at best, we could expect 50% of the consumer benefits in option 2. However, this is probably an overestimate as legal traders likely to engage in unfair practices are unlikely to sign up to a voluntary code of conduct.

Issues of Equity and Fairness

The current system does not provide a fair deal, particularly for sub-prime borrowers who are more likely to suffer from interest rates which represent an exceptionally high risk premium, and other practices that are unfair. At present, it is very difficult for such borrowers to prove that a credit agreement is extortionate. The proposed changes to the Act will protect these consumers by removing unfair traders and better defining extortionate credit and unfair lending practices. Reforming the definition of

extortionate credit on variable-rate loans to include the interest rate in later periods, as well as the interest rate at the starting date of the agreement, is a good example of the added protection built-in by the proposed amendments. This is intended to address the problem lenders increase interest rates when the base rate increase; but do not reduce it
when the base rate falls.

The reforms proposed will increase competition by removing the possibility for unfair competition through the use of hidden pricing. At present, it is possible for traders to cross-subsidise their products by reducing the headline charge (APR) and regaining the capital on hidden costs, such as default charges, early settlement fees, late fees, administrative costs or alterations to the term.

The balance between lenders and borrowers will also be addressed, where necessary. Early settlement fees based on the rule of 78, which is always in favour of the lender, will be removed and replaced with a fair premium.

5. Costs

(i) Compliance costs

Option 1: No additional cost

Option 2:

Transitional Costs

Costs for lenders making the transition to the new regulatory framework are estimated to be in the region of £127m. These costs reflect the regulatory reforms as set out in Chapters 2 and three.

These costs consist of IT development and installation, management time, staff training, legal advice (in re-designing contracts), administration costs and increased business risk.

Reforms to the way in which early settlement fees are calculated require businesses to make substantial changes to IT systems. There are also IT costs involved in redrafting the form and content of agreements. In addition, there will, inevitably, be IT costs for those lenders that choose to sell credit products online (in response to the reform to regulations
governing online transactions).

General business risk will increase as consumers are empowered through a more effective means of redress, such as the ADR. This empowerment will lead to an initial increased cost to business as current practices are challenged. However, as rogue traders are forced out of the market and problematic practices are eradicated, we would expect the ongoing cost to business to fall. We estimate increased business risk to total £8 million in the first year after the reforms. This represents the cost to lenders of higher consumer complaints than anticipated in the ADR running costs. The

transitional business risk is a third higher than the ongoing business risk, to reflect an initial surge in complaints once the service
becomes available.

Training staff to use new systems will also impose a substantial transitional cost to business. However, this cost may be mitigated by lenders' staff turnover and ongoing training strategies.

These transitional costs will be mitigated by:

• Allowing lenders a period of preparation and adjustment before implementation is required. (The regulatory reforms of the CCA, as set out in this White Paper, will not come into effect before October 2004. The reforms that require primary legislation will be implemented significantly later.)

• Making the framework as flexible as possible (for example, the removal of the financial limits exemption, will remove the necessity for continual updating of the limit, which has increased from £5,000 to £25,000 since its introduction).

• Simultaneously introducing reforms on transparency (advertising, form and content, online agreements and early settlement), in October 2004, which means lenders will be able to make all the system changes and updates required, in one hit.

• The continued provision of clear guidance by the OFT to enable lenders to adapt to the new framework with minimal disruption.

Compliance Costs

The ongoing impact of the proposed changes to lenders' costs is estimated at £84.4m per year.

The compliance cost, estimated above, results from the licensing fee; introduction of the ADR system; increases in cases going through the ADR system; increased business risk; reduced revenue from early settlement fees; and administration costs from issuing regular statements and possibly dealing with an increased number of early settlements.

The new licensing regime will impose two costs on lenders: the direct cost of the licensing fee and, the indirect cost of complying with these powers. These are the same costs imposed on businesses by the existing licensing regime. The targeted nature of the new regime will need further calculation of the costs specific to different categories of business, and this will be a part of the planned consultation.

We estimate that the ADR system will cost £10m per annum, this is a conservative estimate, and will be reviewed in the forthcoming consultation. Increases in business risk owing to the ADR provision are expected to fall to £6m annually, after the initial transition. There will also be some increase in business risk by allowing the completion of agreements online (through increased exposure to fraud, such as, identity theft – i.e. applying for credit products in someone else's name).

Changes in the calculation of the early settlement fees will reduce business revenue by £60m a year.

Administration costs are expected to total £4.9m, annually.

Option 3:

The transitional and compliance costs of this option would be as option 2, but would only be borne by those lenders who have signed-up to the voluntary code. Assuming a 50% take-up, transitional costs are expected to total £63.5m, and compliance costs are expected to total around £42m. However, there would also be an additional cost of advertising the code of conduct. Ongoing advertising in the press and on radio would be around £500,000 a year.

(ii) Other Costs

We expect that this set of measures will have a negligible impact outside of the credit market. We do not envisage these changes impacting upon the size of the credit market, but do expect the composition of the market to change.

(iii) Costs for a Typical Business

Three types of lenders exist in this market – large lenders, SMEs which are members of a trade association, and SMEs that are not.

The regulation reforms should have a small impact on the costs of larger lenders because these lenders are routinely redrafting and re-printing material, and training staff. They also are likely to have legal and IT staff in-house, and can also recoup these costs more quickly. With an adequate transition period, their additional costs will be very small.

SME lenders who are part of a trade body have greater access to centrally provided advice. This will aid any transition and keep costs relatively low.

We acknowledge that transitional costs may disproportionately fall on SMEs without access to trade association resources. However, we do not envisage that SMEs will find these one-off costs unaffordable or that these costs will place them at any significant competitive disadvantage.
The costs vary substantially between activities. Costs for traders using licences solely for credit brokerage (the most common activity for licence-holders, constituting around 40% of all credit licence-holders) will only increase by the increased licence fee, though those advertising loans may incur some of the costs associated with the advertising regulations. Only licence-holders who engage directly in lending will face the full cost of the reforms.

Breakdown of estimated transitional and compliance costs

Transitional	**Costs**
Business risk	£8m

Staff training	£29.8m
IT	£54.3m
Management time	£9.3m
Legal costs	£11m
Administration costs	£14.7m
Total transitional costs	**£127.1m**
Compliance	
Business risk	£9.5m
Early settlement	£60m annually
ADR	£10m
Administration costs	£4.9m
Licensing fees	To be confirmed
Total compliance costs	**£84.4m**
TOTAL COSTS	**£211.5m**

Breakdown of Cost by Firm

TRANSITIONAL	**Small**	**Medium**	**Large**
Business risk	482	588	888
Staff training	1,797	2,190	3,308
IT	3,274	3,990	6,028
Management time	561	683	1,032
Legal Costs	663	808	1,221
Administration costs	886	1080	1,632
Total	**7,663**	**9,340**	**14,110**
COMPLIANCE			
Business risk	573	698	1,055
Early Settlement	3,617	4,409	6,661
ADR	603	735	1,110
Administration costs	295	360	544
Total	**5,089**	**6,202**	**9,370**

Assumed that 25% of lenders are small, 30% are medium-size, and 45% are large

Risk Assessment

The risks of each individual policy measure are considered in more detail in the respective chapter of the White Paper and in the Regulatory Impact Assessments in the consultation on draft regulations on form and content, online agreements, advertising and early settlement which can be found at the end of this document.

There is a risk that the cumulative effect of the measures proposed in the White Paper could be that the cost of credit rises, especially in the sub prime market. This, in turn,

could make the credit business for small lenders unprofitable and drive them out of the market.

However, collectively, we think this package of policy measures will increase consumer confidence in the entire credit market, including the sub-prime sector. The spur to competition that this generates should allow the more competitive and innovative firms (both small and large) to gain market share, while less competitive lenders are forced out. This will provide benefits to the consumer through lower prices, higher quality, more innovation, as well as giving them the confidence that they are making like-for-like comparisons between products.

There is a small risk that a vacuum will still remain in the sub-prime market, however, there are already signs that larger credit businesses currently operating in the prime market, may branch into the sub-prime sector. A more credible risk is that the reforms increase the cost of lending to the sub-prime market, reflecting the uncertainty of an increased number of challenges to unfair agreements, combined with an already higher-risk premium. However, this should be mitigated over time as case law is developed, providing the average borrower in the sub prime market with better and fairer agreements, as transparency allows the vacuum to be filled by fairer lenders, and alternate sources of credit such as credit unions, COFIs and other social lenders.

The most difficult issue surrounds extortionate credit provision. The issue of whether these measures restrict credit or not, lies within the nature of the test. If the new test would focus unduly on the cost of credit, this could introduce a de-facto rate ceiling. This, in turn, may have a particular effect on the sub-prime market. However we will bear this risk in mind and aim to avoid it when formulating the legislative factors and guidance to define unfair credit transactions to ensure a balance is struck between capturing unfair practices and not placing onerous burdens on the lender.

6. Consultation with Small Business: the Small Firms' Impact Test

Throughout the period of the review we have engaged with key trade associations whose membership predominantly comprises small businesses. We have also met with the owners of small lending businesses from southern Scotland, north Wales, the north west of England, Swindon, Hull and London. In addition, we have obtained advice from businesses that lend extensively to small businesses in sectors, such as, construction, and from businesses that act as consultants to a variety of small businesses inside and outside of the lending community.

On the basis of this, we have concluded that the reforms do not have a disproportionate impact on small business nor will it restrict the ability of small businesses to obtain credit.

7. Competition Assessment

The impact of the proposals on the consumer credit market was assessed in relation to the consultation responses, and was found to be unlikely to raise concerns about competition. In fact, we consider the proposals to be generally pro-competitive as transparency, certainty, and fairness in the market increases. Any change in the

composition of the official lending market will be the result of competitive forces, but will affect small,
medium and large firms equally. While smaller firms could incur slightly higher costs in some instances, we expect this to be offset by the benefits in terms of a more transparent, competitive market, with some consumers feeling more confident in approaching smaller lenders as a consequence.

We acknowledge that the transitional and compliance costs of these reforms will place a burden on all lenders. In particular, there is a small risk that this may raise barriers to entry into the market, particularly for small lenders. However, we believe that the compliance costs will be small relative to the vast sums incurred in successful entry into the market in terms of infrastructure, IT, skills, marketing etc and should not therefore represent a significant barrier to entry. At the same time, there are likely to be significant benefits as rogue traders are eradicated from the market and their market share is spread among the fair and honest lenders.

8. Enforcement and Sanctions

While we are proposing significant reform of the regulatory regime, we do not envisage any changes to the existing enforcement arrangements which include criminal and civil sanctions, statutory powers available to the court in relation to the enforceability of agreements, and powers bestowed upon the OFT in relation to advertising for which local authority trading standards departments (TSDs) have day to day authority.

The proposals on licensing will enable the OFT to take sanctions against lenders in a wider range of cases and will, therefore, lead to a larger number of appeals against these determinations. It is predicted, however, that after an initial peak, the number of cases should fall back to their current level as lenders' standards increase. Experience from the FSA shows that businesses raised their game before the introduction of new regulations.

The proposals on extortionate credit are designed to make it easier for the courts to intervene where borrowers are being exploited. It has therefore been estimated that the number of complaints and court cases will increase as the new system is implemented.

We have indicated that we intend to introduce an Alternative Dispute Resolution ('ADR') process for consumers seeking redress. This will provide consumers with an additional form of redress.

The recent DTI survey showed that people are generally unwilling to go through the court process, but would be more willing to challenge the terms of an agreement through some alternative route, such as a third-party intermediary or a financial ombudsman. Therefore, it is anticipated that the number of cases dealing with extortionate credit may increase. However, it is envisaged that these cases should be resolved at no cost to the consumer, although the costs to lenders and traders will increase on the assumption the number of cases increases compared with the number that currently go to court.

9. Monitoring and Review

The Government is committed to conduct a review within three years of any regulatory changes it introduces, utilizing the success measures outlined in Annex A.

10. Consultation

(i) Within Government

We have consulted the OFT, HM Treasury, the Cabinet Office, DCA, devolved administrations, Number 10, the Social Exclusion Unit, DWP, DfES and FCO.

(ii) Public Consultation

The review has been overseen by a board chaired by DTI and comprising representatives from:

• The Citizens Advice Bureau – to provide an understanding of the difficulties experienced by consumers;

• The Finance and Leasing Association – who represent a wide range of lenders;

• The Office of Fair Trading – to provide an overview of the role of the enforcement authorities; and

• An academic lawyer—to ensure that our work takes account of wider legal implications.

We have undertaken six formal consultation exercises:
• July 2001: an overview of the CCA and priorities for reform entitled: Tackling the loan sharks. We received 107 responses to this consultation.

• March 2002: increasing or removing the £25,000 financial limit in the CCA and reviewing the status of some exempt agreements, to which we received 55 responses.

• August 2002: making the regulations on early settlement fair and equitable to both lenders and borrowers, to which we received 38 responses.

• December 2002: we received 35 responses to a consultation paper on enabling lenders and consumers to be able to enter into and conclude credit agreements by electronic means.

• January 2003: we consulted on the reform of the consumer credit licensing regime and received 57 responses.

• March 2003: we received 70 responses to our consultation on the reform of the protections offered to consumers in respect of extortionate credit.

Each of these consultation papers has been issued for a minimum of twelve weeks and has been sent to interested parties, as well as being available electronically on the DTI website.

These formal consultations have been supplemented by a series of meetings with key stakeholders to generate proposals in areas, such as, advertising and the form and content of agreements, and understanding the wider impact of the proposals on lenders. We have also consulted with the FSA, a statutory regulator, and have other consultations planned for the future, as outlined in chapter 6.

Our understanding of the credit market has been supplemented by independent research on:

• Extortionate credit in the UK

• The US credit market

• The Cause, Extent and Effects of Over-indebtedness

• Consumer Credit Awareness survey

Wider social concerns about the rise in levels of consumer debt have been addressed by the Taskforce on Tackling Over-indebtedness, which was set up in October 2000. Its remit was to address concerns about consumer debt in the UK by considering ways of achieving more responsible lending and borrowing. It has reported twice to Ministers and
many of their recommendations have been incorporated in this proposal.

Several members of the team have been seconded from major lenders to provide a detailed insight into how regulations are viewed and interpreted. Finally, members of the Civil Service have spent short periods shadowing staff of various lenders to gain a firsthand understanding of the way different sectors within the financial industry are involved in consumer credit.

11. Summary and recommendation

Option	Total cost per annum	Total benefit per annum
1	No additional cost over the current system. Consumer detriment will continue and fair lenders will continue to lose out to unscrupulous lenders.	
2	**Increase in ongoing costs estimated as £84.4m, of which:** Reduced revenues to lenders from excessive early settlement fees of £60m. Business risk: £6m to allow for the	**Total benefits of £384m, of which:** Consumers benefit from a direct reduction in unfair settlement fees of £60m. We also estimate that consumers

	increased risk of being challenged over agreements or practices through the ADR, and £3m for identity fraud, if companies opt for online completion. ADR system cost of £10m Administration costs of £4.9m include more frequent statements. Implementation costs of new regulations: £127.1m of which: IT costs £54.3m, the majority is allocated to early settlement system changes, with the remainder going on form and content and online contractual changes. Staff training: £29.8m Administration: £14.7m Approximately £10m allocated to both legal costs and management time. £8m in business risk has been allocated to account for the initial surge in demand for ADR.	will derive £306m in benefit through switching to more suitable loans. Greater competition will bring improvements in price, choice, quality, and innovation. This will benefit both consumers and lenders, with most competitive lenders gaining market share. Businesses will also derive benefit in the region of £15m from fewer consumer complaints, and £3m from lower compliance costs as a result of clearer legislation.
3	Based on our assumption of a maximum 50% sign-up rate to voluntary codes of conduct, we estimate the costs to be half those of the above option, and quite possibly less, because, as already mentioned above, the requirements will be less strict.	At best we can expect 50% of the benefits under option 2.

12. Recommendation

It is considered that Option 2 would promote competition, a consistent and fairer deal for consumers and business, and allow confidence in the credit market to grow. These benefits, when considered together, provide a transparent, fair and adaptable framework that will allow the credit market to continue to develop and innovate. Option 2 is consistent with Government objectives to promote competition and empower consumers, while still providing protection for vulnerable groups. This

option is expected to promote efficiency and allow savings for business, consumers and Government in the longer term.

Annex B

CONSULTATION PAPER "ESTABLISHING A TRANSPARENT MARKET"

ON-LINE AGREEMENTS

The Internet has become an important means for many consumers of purchasing goods and services.

The Consumer Credit Act 1974 was conceived with paper in mind and there is at present no clear provision in the Act or Regulations for facilitating or regulating the conclusion of electronic contracts.

The Consultation issued in December 2002, identified four main issues upon which we sought views and below we have set out our policy proposals in each respect.

The results of the consultation will be summarised on our website on the 15 December 2003 but the main ones were:

• strong support for a single regime covering the Electronic Commerce Directive (ECD) and Distance Marketing of Consumer Financial Services Directive (DMD) requirements;

• widespread agreement that concluding an agreement on-line did not necessarily require one particular form of digital signature;

• Pressure for developing regulations that are as 'future proof' as possible; and

• General agreement that important documents, such as default notices, should be sent by post.

Proposals

1. The decision to contract electronically

We want to make it possible, but not mandatory, to contract electronically. The decision for both the lender and consumer as to whether to choose this medium raises a number of issues, such as whether they are able to do so technically, whether they have consented to doing so, and the reliability of the communications.

General Legibility Requirement

A general legibility requirement set out within the Agreements Regulations will be retained as it is generally accepted that prescribing a minimum font size will not necessarily be appropriate for text on a computer screen (as this can be altered by the reader, depending upon the equipment they are using).

Record Keeping

In accordance with the requirements of both the ECD and also the DMD (from which the ‘durable medium’ requirement stems) we will introduce a requirement for consumers transacting on-line to receive in a form which can be stored in a ‘durable medium’ copies of the documentation received from the lender.

We will not impose a requirement upon the lender to determine, in advance of agreeing to contract electronically, whether the consumer has the capability to be able to store and reproduce them electronically.

Post Agreement Communications

Important Communications:

The current provisions under the Act require that paper copies of various notices/documents be provided to consumers at various times during the application process, and during the lifetime of the agreement, for example cancellation notices and default notices.

From the consultation responses we received, we consider that two of the notices (default and cancellation) are of sufficient importance that they should not simply be sent by electronic means. The consequences of failing to read and act on these documents can be particularly severe for the consumer. As postal communications are much more difficult to overlook or to destroy accidentally than electronic communications, we believe that it is necessary for the protection of consumers to continue to require these documents to be sent to consumers on paper. However, we will not preclude lenders sending both an electronic and paper version if they wish.

Other Communications:

Otherwise, we propose that the medium for the conclusion of the contract should determine the way in which the notices should be delivered to the consumer. Therefore, as a general rule, where a consumer agrees to conclude a credit agreement electronically, any future communication should also be by electronic means. It will, however, be possible for lenders/consumers to amend the means of communication. We do not propose to prevent a lender from charging a ‘reasonable’ fee, should the change in method of communicating with the consumer be at the request of the consumer and be more costly to the lender.

Deemed Receipt:

We are considering whether we should provide for deemed receipt after a certain period from transmission. We are minded to adopt an approach where, for example, delivery is deemed to have been effected at the end of 48 hours after the time at which the electronic communication is sent.

2. The Form of a Credit Agreement

Legislative references to writing may include electronic writing but this obviously does not apply where the context makes clear that Parliament intended to limit the methods of communication to paper-based methods only.

We are concurrently making changes to the Consumer Credit (Agreements) Regulations 1983 which will apply equally to paper as to electronic transactions. This will ensure that we achieve a technology neutral approach and the prescribed information and layout of agreements will be the same regardless of the method of contracting.

We have determined that one of the areas we need to address specifically is the provisions within the Agreements Regulations which refer to colour of paper.

3. Signature Requirements

We have concluded that it is not appropriate to require one particular form of digital signature for on-line agreements. Regulations will set out how the consumer's consent is to be indicated in on-line agreements.

Provision for an indication of consent would create a specific distinction between paper and electronic based transactions when considering the signature requirements. We are of the view that where a contract is concluded in a paper format, we will retain the requirement that a signature will be necessary to evidence consent to enter into the agreement.

4. Copies and Cancellation

Copies of Documents

We intend to introduce a requirement allowing copies of documents to be provided by electronic means, including the final, executed copy of the agreement provided the consumer has agreed with the lender that they will communicate using electronic means. However, the lender needs to ensure that the copy retained by him is capable of being stored in a durable medium so that it can be reproduced at any time.

As is currently provided for under the Act, consumers will be able, upon payment of a prescribed fee, to request a copy of the executed agreement at any time during the course of the agreement.

Question 35: What additional costs will lenders incur as a result of implementing these changes to allow agreements to be concluded electronically?

Question 36: Will costs be different for different types of businesses?

Annex C

RESPONSE TO CONSULTATION PAPER "ESTABLISHING A TRANSPARENT MARKET"

Online Agreement Regulations

140. The regulations to facilitate the transactions of consumer credit agreements electronically are hoped to be available within the next two months. As it is enabling legislation, not requiring companies to do anything but allowing them to contract by electronic means if they so choose, lenders will not be faced with compliance difficulties as a result of the limited notice so we still intend to bring the regulations into force on 31 October 2004. We aim to publish them as soon as they are agreed in-house. We aim to provide sight of Draft regulations for all stakeholders at the latest early September.

Breakdown of Responses

141. In total 24 responses were received, the breakdown of which was:

- Trade Association/bodies – 5
- Lenders – 8
- Regulatory/Supervisory bodies inc. Trading Standards – 4
- Consumer Organisations – 4
- Legal/academic – 2
- Others – 1 (companies and individuals)

Questions 35 - 36

Question 35: What additional costs will lenders incur as a result of implementing these changes to allow agreements to be concluded electronically?

142. Generally consumer consultees welcomed the proposals although it was noted that on-line transacting would bring about both costs and cost savings. It was noted that there were really no regulatory costs since companies were not to be forced to transact business in this way. Two respondees noted that important documentation (default notices etc) should be sent by hard copy mail as well. Solitary comments included that there should be a separate dispute resolution system for IT because of its frequent problems; that a license requirement should be that websites were secure and that consumers should be warned how data might be shared.

143. Business consultees generally also welcomed the proposals. There were three estimates of actual one-off costs ranging from £40,000-300,000. Three respondees suggested that lenders and consumers should be allowed to switch from IT to paper – or vice versa - during the process of contracting. One of these, plus another lender, noted that if consumers demanded to switch from a cheap IT mode of communicating to an expensive paper way, after their contract had started, then they should be charged any higher costs they caused. Solitary comments included that money laundering checks would add to the costs; that the consent indicator would be an important determinant of success for on-line; that prescribed digital signatures could

be very expensive; that attempts should be made to future proof and encompass uninvented methods and that any regulations should not be too prescriptive.

Question 36: Will costs be different for different types of businesses?

144. Few consultees responded to this question but those that did made the point that SMEs would have higher proportionate costs than larger firms.