

Bonus Question 3

‘Through the wider regulation of unfair credit transactions, and a new alternative dispute resolution mechanism, the position of vulnerable debtors has been improved by the **Consumer Credit Act 2006**.’

► Critically discuss the above statement.

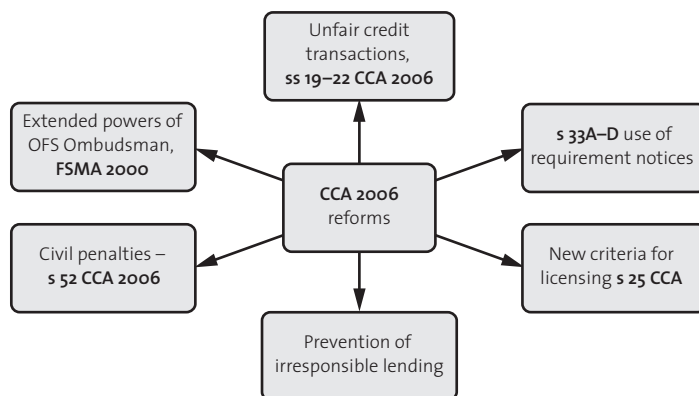
How to Answer this Question

The vulnerability of debtors who are offered unsuitable loans and forced to borrow, often on disadvantageous terms, from unscrupulous lenders in the so-called sub-prime market, has been an issue of concern to regulators and other consumer groups for some years. The question requires candidates to consider two areas of reform introduced by the **Consumer Credit Act 2006**:

- 1 new provisions to regulate unfair credit transactions in **ss 19–22 of the CCA 2006**;
- 2 the extension of the powers of the Financial Ombudsman Service; and
- 3 the new focus on prevention of irresponsible lending.

The candidate should seek to assess whether these changes, taken together, will provide more effective protection for such vulnerable debtors, than those provided for in the **Consumer Credit Act 1974**.

Applying the Law



*This diagram shows the main factors relating to the **CCA reforms** that are relevant to the application of law in this answer.*

ANSWER

INTRODUCTION – CONTEXT OF REFORMS

At the time of its passage, the **Consumer Credit Act 1974** was hailed as the most sophisticated and comprehensive consumer credit regime in the world. However, in the intervening period there have been massive changes in the amount of credit granted and the structure of the consumer credit market.¹ One area of concern, however, has proved stubbornly resistant to effective legal remedy, and that is the problem of poorer vulnerable debtors who borrow from sub-prime lenders, sometimes known as non-status lending (see *OFT Guidelines – Non-Status Lending: Guidance for Lenders and Brokers* (1997) Office of Fair Trading 192). A sub-prime loan is simply one made outside the prime market, which comprises mainstream lenders such as the major clearing banks and their subsidiaries. People who cannot borrow in the prime market are often forced to borrow in the sub-prime market on more expensive terms, in terms both of interest rates and of expensive default charges, and often at the mercy of more unscrupulous lenders. In some cases these lenders will be unlicensed, and thus committing a criminal offence (s39 of the **CCA 1974**). Illegal actions such as threats of violence, harassment and seizure of benefit books as security are not uncommon. Trading standards authorities have found it very difficult to assemble evidence in relation to such activities and to persuade frightened debtors to come forward and give evidence. One of the aims of the reforms introduced by the **CCA 2006** is to address these issues.

SECTORAL REVIEWS²

Under their general oversight role in relation to consumer credit matters the OFT in February 2012 (OFT Press Notice 11/12, 24 February 2012, 'OFT launches review into payday lending', www.of.gov.uk/news-and-updates/press/2012/11-12) announced a review of the growing use of so-called 'payday loans', high interest short-term credit often to the most vulnerable consumers. Key issues to be focused on are:

- ❖ giving loans without first checking adequately that the borrower can afford to repay them;
- ❖ inappropriately targeting particular groups of people with clearly unsuitable or unaffordable credit;
- ❖ rolling over loans so that charges escalate and the loans become unaffordable; and
- ❖ not treating borrowers that get into difficulties fairly.

UNFAIR CREDIT RELATIONSHIPS

Sections 137–140 of the **CCA 1974** gave the courts a very wide discretion to reopen extortionate credit bargains,³ which were agreements that required the debtor to make

¹ Be prepared to challenge the assumptions made by the question, don't merely agree with the statement made because it is easy. You are assessed on the ability to think critically, i.e. your ability to consider opposing arguments.

² Credit always to be gained by referring to current reviews, inquiries and reports in overview questions shows you are in command of subject.

³ When revising ensure you use up to date texts. Marks will be lost by discussing repealed provisions – companion websites are a good source where using an edition which is a couple of years or more old.

payments which were grossly extortionate or which otherwise grossly contravened the principles of fair dealing. The provisions, however, were not a great success, partly because they relied on the individual debtor taking legal action or raising the provisions by way of a defence, which few did, and the bar for court intervention was set at too high a level. The credit agreement did not merely have to be unfair or unreasonable but grossly exorbitant or grossly extortionate, which was a difficult hurdle to surmount. The **CCA 2006** repeals these provisions, and by **ss 19–22** of the **CCA 2006** introduces new powers for the intervention if the agreement is unfair to the debtor. Unfairness is not defined but analogies may be drawn to the **Unfair Terms in Consumer Contract Regulations 1999** (see *Director General of Fair Trading v First National Bank* (2001)). In one key respect these provisions are wider, in that they cover both core and non-core terms, so can be used in relation to excessive interest rates.⁴ The court can take account of the whole relationship between the debtor and creditor arising out of the principal credit agreement and any related agreement (such as a brokerage or payment protection plan) and is unfair because of any of the terms of the agreement or of any related agreement or by the way in which the creditor has exercised or enforced any of his rights under the agreement or related agreement. The powers are also wider than those in the **CCA 1974** in that the courts can look not only at the position when the agreement is entered into but how the agreement is being enforced. The court can take account of any relevant factor relating to the debtor or creditor. Extensive powers are given to set aside the agreement, vary it, reduce or discharge any sum payable or set aside any security given. It is also important to note that if the collective interests of debtors are being affected by the use of unfair agreements the OFT (or other qualified body such as a local trading standards department) can seek a voluntary assurance that the creditor desist from using such agreements or if necessary apply for a court injunction restraining the creditor from continuing to use the offending agreement or terms (**Pt 8** of the **Enterprise Act 2002**). It is important to note that these orders only apply to the creditor's future conduct and do not provide for payment of compensation to individual debtors for past breaches. The OFT has issued a guidance document, 'Unfair Relationships' OFT 854, May 2008, on how they intend to use their powers under **Pt 8** to secure voluntary assurances and court orders in this area.

Already a steady jurisprudence is building up on unfairness – see *Shaw v Nine Regions* (2009), *MBNA Europe Bank Ltd v Lynne Thorius* (2010), *Upendra Rasiklal Patel v Vithalbhai Bikabhai Patel* (2009) and *Tew v Bank of Scotland (Shared Appreciation Mortgages) No 1 Plc* (2010).⁵

The issue has been raised in a number of cases arising out of the PPI scandal – the mis-selling on an industrial scale of payment protection insurance policies by creditors. An important, if unsuccessful, invocation of the jurisdiction was the case of *Harrison v Black*

.....
4 Providing clear and complete descriptions and explanations not only helps you to properly apply the law to the requirements of the question, it also shows your knowledge. Remember that accuracy is an important assessment factor.

5 Showing an awareness of the development of the area of law in question demonstrates both knowledge and understanding.

Horse Ltd (2011).⁶ The court refused to set aside a credit agreement despite the fact that the bank received a very substantial 87% commission on the PPI policy made with an associate company. Overall the policy was expensive and poor value relatively speaking. However the terms and conditions had been explained to the debtors and at this point the Insurance Conduct of Business Rules which applied under the **Financial Services and Markets Act 2000** did not require disclosure of commission. The Court of Appeal took the view that it would be wrong in effect to impose a higher duty under the **CCA 1974** on banks and insurers than that required by the Financial Services Authority under the **FSMA 2000** regime. The case has been appealed to the Supreme Court.

NEW DISPUTE RESOLUTION REGIME⁷

Vulnerable debtors are extremely reluctant to use the courts even if they are aware of their rights, which in many cases they are not, and so many of the protections provided by the **CCA 1974** were theoretical rather than real. A key plank of the **CCA 2006** is to provide a less formal and cheaper method of dispute resolution. This is done by extending the jurisdiction of the Financial Ombudsman Service ('FOS') set up under the **Financial Services and Markets Act 2000** (ss 59–61 and **Sched 2** of the **CCA 2006**). The scheme is free for the individual debtor to use and is financed by fees and levies on the consumer credit industry. The FOS can award up to £150,000 in compensation (it can recommend higher payments but these recommendations are not binding), including damages for distress and inconvenience caused by the actions of the creditor. The awards are enforceable as court judgments. If a debtor is unhappy with how he has been dealt with by the creditor in relation to any matter connected with the credit agreement, the debtor, after first exhausting the creditor's internal complaints procedure, which he is required to have under the scheme, may take the matter to the FOS. Only if a complaint to the creditor fails to resolve matters can the complaint be taken to the FOS. If unhappy with the award of the FOS, the debtor can go the courts, but the creditor is bound by the ruling, subject to any judicial review challenge, for example that the FOS has exceeded its jurisdiction or acted unfairly. The defendant can contend that the complaint raises a novel point of law with significant consequences, and if the FOS agrees that it would be more suitably dealt with as a test case, it can be pursued in the courts, but the defendant creditor must agree to pay the costs of the complainant even if the complainant is unsuccessful. The courts accord the FOS a very wide discretion, and providing the decision is fair and reasonable in all the circumstances, the FOS is not bound to follow the strict letter of the law, subject only to their decision being set aside on the grounds that it was perverse or irrational (*R (on the application of Heather Moor & Edgecomb Ltd) v Financial Ombudsman Service* (2008)). Issues 68, 75 and 81 of the *Ombudsman News* feature a useful cross-section of decisions of the FOS: www.financial-ombudsman.org.uk/publications/technical_notes/consumer_credit_resource.html.⁸

6 Marks to be gained by reference to topical scandals and controversies such as mis-selling of Payment Protection Insurance – PPI.

7 Remember now that consumers have access to a free dispute procedure. Lots of useful decisions and articles about this area are on the Financial Ombudsman Service website. Marks are to be gained by reference to these on such things as unfairness disputes.

8 The inclusion of other relevant sources rather than the 'mere' consideration of case law shows not only that you have researched and read more widely but also adds to the criticality of your analysis.

The FOS has received a number of complaints from consumers who believe their loan agreements may be 'unenforceable at law'. Because the ombudsman service is not a court, the FOS has no power to declare a loan agreement unenforceable – and so the ombudsman is not the best forum for this kind of complaint. However the FOS can consider issues relating to such an unenforceable agreement such as whether the loan was unaffordable from the outset or whether information provided by the lender was misleading about the cost (or other benefit) of taking out the loan. Huge numbers of complaints have made about the mis-selling of PPI policies.

A challenge to the largely documents based system and wide unfairness jurisdiction as being incompatible with **Art 6 European Convention on Human Rights 1950** was declared inadmissible in *Heather Moor & Edgecomb Ltd v UK* (2011).

IRRESPONSIBLE LENDING

One way of course of avoiding problems and disputes is to ensure that borrowers act prudently in the first instance and that creditors do not create debt problems building up by irresponsible lending.

Lenders engaging in irresponsible lending and encouraging debtors to take on unsuitable and unsustainable commitments may find they lose their licences. This is reinforced by **Art 8.1** of the new **EU Consumer Credit Directive, 2008/48/EC ('CCD')**, which requires the creditor to assess the consumer's creditworthiness on the basis of 'sufficient information', which will include access on a non-discriminatory basis to databases across the European Union (**Art 9 CCD**).

It can also be noted that further reforms introduced by the **EU Consumer Credit Directive 2008/48/EC** require prospective creditors to assess the 'creditworthiness' of prospective debtors and to provide an 'adequate explanation of the nature of the credit agreement being entered into'.⁹

⁹ Relating the essay question to its wider (here: European) context is another way to demonstrate knowledge and understanding.