RECENT DEVELOPMENTS IN CONSUMER FINANCE: KEEPING THE ENGINE RUNNING

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The increasing popularity and widespread offering of "buy-now-pay-later" type financial products, often offered by unregulated specialist firms in the market, has recently brought increased focus to the regulation of consumer credit firms and the treatment of consumers thereunder. Coupled with the lingering effects of the FCA payment deferral guidance and the introduction of the Breathing Space Regulations, regulation of consumer finance offerings continues to be a developing landscape for creditors, debtors, and investors. In this article, we review some of the recent changes to the regulation of consumer finance and discuss their expected effects on securitisation of those products.

Buy-now-pay-later products and the Woolard Review Report

The rising prevalence of the "buy-now-pay-later" ("**BNPL**") market and the popularity of such financing offerings with consumers has resulted in recent media and political attention on the unregulated nature of the market and firms offering such products. As a result, in Q4 2020, the FCA instructed a review and report on the unsecured consumer credit market with particular focus on the BNPL market (the "**Woolard Review Report**").

The Woolard Review Report was published on 2 February 2021 and contained 26 recommendations covering a number of areas. Most notably, the review recommended that BNPL lending be brought within the scope of consumer credit regulation "urgently". On 21 October 2021 HM Treasury published a consultation on the regulation of BNPL products which closed on 6 January 2022. This consultation sets out a number of policy options in respect of the scope of regulation and the range of regulatory controls that could be put in place, focusing on those elements of lending practices most closely linked to potential consumer detriment.

Key recommendations arising from the Woolard Review Report

As highlighted above, the Woolard Review Report recommended that BNPL lending should be brought within the scope of existing consumer credit regulations. Although it did not say whether such lenders should be required to be authorised as full-scope or limited permission consumer credit firms, the Woolard Review Report clearly suggests a move away from allowing BNPL lenders to operate on an unregulated basis in reliance on an exemption under the existing regulations. The report focussed on a number of key areas of customer detriment that currently arise due to the unregulated nature of BNPL providers, including administration of late fees, referral to debt

collection agencies, potential impact on credit scores through reports to credit reference agencies, lack of effective affordability assessments and the high risk of repeat borrowing from customers.

The Woolard Review Report also contained broader conclusions relating to the unsecured consumer credit industry, advising that measures should be introduced in the following areas:

- *Debt advice:* The report noted that the provision of debt advice is critical to a sustainable market in the long term, particularly in the context of Covid-19 and the ongoing effects thereof. The report highlighted that funding should be provided on a long-term basis to services that provide free debt advice to consumers. It also recommended that funding be put in place to help the poorest customers pay fees when applying for debt relief orders.
- *Alternatives to high-cost credit:* The report noted the importance of sustainable alternatives to high-cost credit for consumers and urged the government to reform the existing regulation of credit unions and community development finance institutions, as well as providing incentives for mainstream lenders to operate in this space and offer sustainable lending opportunities to consumers.
- *Forbearance:* The report recommended that the FCA examine how forbearance measures are implemented by firms (particularly when it comes to payment deferrals granted following the FCA Covid-19 guidance), and that greater transparency and consistency across regulated firms was needed in respect of what customers are offered. It also noted that Covid-19 payment deferrals are currently "masked" from credit reference agencies as lenders were not permitted to report application of payment deferrals to such agencies, and the report urged further FCA studies on the market to examine whether this was the best approach for consumers on a long-term basis.

Finally, the Woolard Review Report recommended a fresh look by the FCA at consumer credit legislation generally to ensure that the legislation was producing the intended outcomes for consumers, with use of relevant products and services in practice as the relevant metric. Repeat lending to consumers was identified as a key risk area the FCA may look into with a view to further action. While current consumer credit rules under the FCA's Consumer Credit sourcebook (CONC) adequately addressed the initial affordability assessments carried out by firms, the report indicated that broader regulation should be introduced to address the risks posed by consumer lending throughout the life cycle of a product – for example, the risk of multiple credit cards which, individually, would satisfy firms' affordability assessments, but collectively left consumers at risk of persistent debt.

Breathing Space Regulations

On 4 May 2021, the Debt Respite Scheme (Breathing Space Moratorium and Mental Health Crisis Moratorium) (England and Wales) Regulations 2020 (the "**Breathing Space Regulations**") came into force. The Breathing Space Regulations seek to provide legal protections against creditors to individuals experiencing long term debt problems or mental health crises in the UK.

Most types of personal debts and in particular most types of unsecured debt will qualify for a breathing space, including credit and store cards, personal loans, payday loans and mortgage or rent arrears. A breathing space applies to all qualifying debts at the time of entry into the breathing space. Any new debts or arrears that are incurred during a breathing space do not qualify for the relief.

It should be noted that secured debts, including mortgages, hire purchase agreements or conditional sale agreements are not qualifying debts under the Breathing Space Regulations, with the exception of any arrears that already exist as at the date of application for a breathing space. Some other types of debt, such as debts incurred from fraud, court fines, student loans, child maintenance etc. are not qualifying debts regardless of when they arise.

Types of "breathing space"

The Breathing Space Regulations provide for 2 types of breathing space:

- *Standard breathing space:* Available to anyone with problem debt. The breathing space affords legal protections from creditor action for up to 60 days. The protections include pausing most enforcement action and contact from creditors and freezing most interest and charges on the debtor's debts.
- *Mental health crisis breathing space:* Only available to a debtor who is receiving mental health crisis treatment. It affords stronger protection versus a standard breathing space and lasts as long as the debtor's mental health crisis treatment, plus 30 days (no matter how long the mental health crisis treatment lasts).

Generally, a breathing space can only be accessed by seeking debt advice from a debt adviser. For a standard breathing space, the debt adviser must be satisfied that the debtor cannot, or is unlikely to be able to, repay all or some of their debt. The debt adviser is required to take into account the usual considerations around appropriateness of the debt solution for the individual at hand, including whether alternative solutions would be more appropriate (for example, assistance with budgeting or debt solutions that can be accessed more immediately). The debtor themselves must also satisfy certain conditions including not having been subject to an individual voluntary agreement (IVA), debt relief order (DRO) or undischarged bankruptcy against them at the time they apply, and not having been granted a standard breathing space in the 12 months preceding the application.

In order to qualify for a mental health crisis breathing space, the debtor must meet the conditions for a standard breathing space, and also be receiving mental health crisis treatment. Having had a standard breathing space in the last 12 months does not render a person ineligible for a mental health breathing space, nor is there any limit on the frequency with which a debtor can enter a mental health crisis breathing space. It should be noted that the mental health crisis breathing space is limited to those receiving acute mental health treatment and/or are being detained in specialist mental health service or institution, meaning the bar for applying is high.

Impact on creditors

Once a breathing space is applied, creditors (and anyone acting on behalf of creditors) are subject to restrictions and obligations imposed by the moratorium on collection

and enforcement of debts, and creditors are restricted from applying interest and other charges on the qualifying debts subject to a breathing space.

Note that a distinction is different to a payment holiday; a breathing space only applies to debts that already exist when it begins. As such, although creditors are restricted from enforcing qualifying debts during a breathing space or charging interest or fees on that qualifying debt, a debtor remains legally required to pay their debts and liabilities and should continue to pay any non-qualifying debts and liabilities owed to creditors as they fall due. In fact, in the case of a standard breathing space, failure by the debtor to continue to pay certain ongoing liabilities (such as mortgage payments, local taxes, water bills etc.) could lead to the debt adviser cancelling the breathing space.

FCA payment deferral scheme

As consumers roll off existing payment deferrals under the FCA's payment deferral scheme introduced to combat the impact of Covid-19, there remain lingering considerations for firms relating to the treatment of consumers who continue to experience difficulties as a result of the ongoing Covid-19 pandemic. FCA guidance emphasises the overarching principles of ensuring affordability of credit for consumers and ensuring that ongoing and appropriate forbearance is made available to consumers to the extent needed as their payment deferrals come to an end. Although the impact of the specific Covid-19 FCA guidance has already started to tail off, the resulting themes from the Covid-19 related guidance are likely to continue, with increased focus from the FCA on firms considering each individual's (or cohorts of individuals') circumstances appropriately to offer sustainable forbearance measures.

New FCA "consumer duty"

The FCA published a consultation on a new "consumer duty" on 14 May 2021 (CP21/13), which would set higher expectations for the standard of care that firms provide to consumers. For many firms, this would require a significant shift in culture and behaviour, where they consistently focus on consumer outcomes, and put customers in a position where they can act and make decisions in their interests. The consumer duty would be a package of measures, including a new "consumer principle" that provides an overarching standard of conduct, supported by a set of "cross-cutting rules" and outcomes that set clear expectations for firms' cultures and behaviours. The consumer duty would give firms more certainty about the standards that the FCA expects of them and, correspondingly, the standards that consumers can expect of firms.

In this consultation (which has now closed), the two options for the new consumer principle were (a) "A firm must act to deliver good outcomes for retail clients"; or (b) "A firm must act in the best interests of retail clients".

The consultation specifically references certain consumer credit products such as credit cards as not being at all times fit for purpose – for example, the ability of customers with credit cards to over-borrow and under-pay is problematic, as are the opaque charging structures in many products. The introduction of this new consumer duty is likely to have a significant impact on firms' lending policies.

Notably, this consultation also considered the potential merits of extending the existing "private right of action" ("**PROA**") under section 138D Financial Services and Markets Act 2000 to include a right of action for a breach of the FCA's principles – as opposed to a breach of specific Handbook rules, as is the current position. This proposal is under discussion, but could significantly broaden consumers' ability to take action against firms which they consider have treated them unfairly. However, in its second consultation (discussed below), the FCA propose not to provide a PROA for breaches of any part of the consumer duty at this time.

The FCA published its second consultation on a new "consumer duty" on 7 December 2021 (CP21/36) which closed on 15 February 2022. This second consultation sets out the key feedback from the first consultation and the FCA's analysis of the responses, revised proposals for a new consumer duty with proposed Handbook rules and guidance, and a cost-benefit analysis. The FCA propose going ahead with the first option for the new consumer principle so that "[a]firm must act to deliver good outcomes for retail clients". This will be supported by three cross-cutting rules and four specified outcomes. The proposals under this consultation are not yet finalised, but the FCA has committed to publishing the policy statement summarising responses and setting out new rules by 31 July 2022.

Impact of developments

In practice, regulations such as the Breathing Space Regulations imposing a moratorium on enforcement and charging of interest or fees is likely to have a limited impact on securitisation cashflows. The widespread market expectation is that loans subject to a breathing space will not make up more than a small proportion of securitised pools. Manoeuvring securitisations and financings around requirements to ensure consumers are made aware of any creditor by assignment (which would, in a typical securitisation structure, include the relevant financing special purpose vehicle) is a matter originators and servicers will wish to consider. However, the practical impact is likely to be minimal where origination, legal title and servicing remain with the same entities, and managing the effect of the Breathing Space Regulations on an ongoing basis is likely to be mostly a matter of internal governance. With regard to transactions using third party servicers (as may be more typical in the acquired or third-party-originated space), the management of breathing space and notification requirements are likely to require some system adaptations.

As the recommendations in the Woolard Review Report start to be implemented and proposed guidance and/or legislation is published by the FCA, there is likely to be some noise as to the impact of the updated legislation and in particular how previously unregulated BNPL firms bring themselves in line with other regulated firms to ensure compliance with both the letter and the spirit of the regulation. The introduction of the new package of measures relating to the FCA's consumer duty will also require firms to carefully examine their existing policies and practices in dealing with, and lending to, consumers. Even where firms already have in place ongoing policies and procedures that are broadly in line with regulated products as a matter of good practice, a shift in outlook and policy is likely as firms adapt to a more closely regulated environment that is receiving increased focus from national regulators.

AUTHORS

Andrew E. Bryan
Knowledge Director
London
T: +44 20 7006 2829
E: andrew.bryan@cliffordchance.com

Soojean Choi
Senior Associate
London
T: +44 20 7006 1075
E: soojean.choi@cliffordchance.com

Simon Crown
Partner
London
T: +44 20 7006 2944
E: simon.crown@cliffordchance.com

James Watkins
Senior Associate
London
T: +44 20 7006 4576
E: james.watkins@cliffordchance.com

CLIFFORD

CHANCE

CONTACTS

Adam Craig
Partner
London
T: +44 20 7006 8862
E: adam.craig@cliffordchance.com

Kevin Ingram
Partner
London
T: +44 20 7006 2416
E: kevin.ingram@cliffordchance.com

Emma Matebalavu
Joint Head of GFM, London
T: +44 20 7006 4828
E: emma.matebalavu@cliffordchance.com

Simeon Radcliff
Partner
London
T: +44 20 7006 2786
E: simeon.radcliff@cliffordchance.com

William Sutton
Partner
London
T: +44 20 7006 3400
E: william.sutton@cliffordchance.com

Christopher Walsh
Partner
London
T: +44 20 7006 2811
E: christopher.walsh@cliffordchance.com

Maggie Zhao
Partner
London
T: +44 20 7006 2939
E: maggie.zhao@cliffordchance.com

2203-000292