EXPLANATORY MEMORANDUM TO

THE CONSUMER CREDIT ACT 1974 (FEES) ORDER 2010

2010 NO. XXXX

1. This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills (BIS) and is laid before Parliament by Command of Her Majesty.

2. Purpose of the Instrument

This Order is made in exercise of the powers conferred by sections 102(3) and (4) of the Finance (No.2) Act 1987 to provide the legal basis for the Office of Fair Trading (OFT) to set fees for carrying out its functions under the Consumer Credit Act 1974 ("the 1974 Act"), at a level which allows it to recover past deficits as well as to take into account current costs, until the expiry of this Order on 31st March 2013.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative context

4.1 The Consumer Credit Act 1974 provides for the OFT to charge a fee for any service it provides under the Act. The Government's stated aim is that fee levels for all statutory services, in this case the credit licensing regime, should be set to recover the full cost of the service. The credit licensing fees are intended to cover all the OFT's costs in ensuring compliance with the Act and delivering consumer protection in the credit market. Currently, the OFT is not permitted, when setting its consumer credit licence fee, to include any element to recover past deficits.

5. Territorial Extent and Application

5.1 This instrument applies to the United Kingdom.

6. European Convention on Human Rights

Kevin Brennan, Minister for Consumer Affairs, has made the following statement regarding human rights:

"In my view the provisions of the Consumer Credit Act 1974 (Fees) Order 2010 are compatible with the Convention rights."

7. Policy background

- What is being done and why

The credit licensing regime was established under the 1974 Act to deliver consumer protection in the credit market. This is achieved through a positive licensing regime which establishes and monitors the fitness of applicants to hold a credit licence. Licensing is the key regulatory mechanism by which standards of behaviour by credit businesses in their dealings with consumers are maintained.

Under current arrangements, the licensing fee level is intended to ensure that all consumer credit activity is cost-neutral, so that income generated through licensing equals expenditure. This means that the OFT is not permitted, when setting its consumer credit licence fee, to include any element to recover past deficits incurred through the operation of the credit licensing regime. In the event of a deficit, the credit licensing regime will therefore not be run on the basis of full cost recovery. Also, short term variations in the number and type of credit licence applications risk a reduction in enforcement expenditure, which introduces the potential for significant consumer detriment.

New licence applications and renewals in 2008-09 were significantly below the expected level, due to the downturn in the credit market, combined with businesses reconsidering whether they are engaged in licensable activities, especially in high-risk activities, given the increased rigours introduced by the Consumer Credit Act 2006 (CCA06). The more rigorous regime introduced under CCA06 also means that OFT expenditure to achieve compliance has increased.

The objective of the Order is to ensure that the OFT is able to run the consumer credit licensing regime on a full cost recovery basis by having the power to balance out discrepancies between income and expenditure over a longer period. This will allow shortfalls, caused by inevitable variations in application numbers and type, to be met from fee income paid subsequently. Any fee increase must be approved by BIS and HM Treasury Ministers and published by the OFT in a General Notice no less than 6 weeks before the increase takes effect.

8. Consultation outcome

8.1 No consultation was held. The Order merely grants the power for the OFT to be able to set fees to recover deficits in future.

9. Guidance

9.1 No guidance has or will be issued.

10. Impact

10.1 An Impact Assessment has been prepared for this instrument.

11. Regulating small business

11.1 It is unlikely that licence fee increases will be prohibitively expensive for small consumer credit licence-holders. For example, if the deficit of £98,000 incurred in 2008/9 were to be recovered through an increase in the licence fee applied equally across all licence-holders, the increase for each licence-holder would be less than £1.

12. Monitoring and review

12.1 As set out in the recent Consumer White Paper[1], a fundamental review of the consumer credit licensing fees structure will be undertaken by the OFT in early 2010, with any new fee structure formally introduced in 2011 (after trialling in 2010-11).

13. Contact

Susan Walker (020 7215 6427), or Louise Marfany (020 7215 5920) Consumer and Competition Policy Directorate, the Department for Business, Innovation and Skills, can answer any queries regarding the instrument.

[1] 'A Better Deal for Consumers: Delivering Real Help Now and Change for the Future' (2009)

Summary: Intervention & Options

Department /Agency: Office of Fair Trading	Title: Impact Assessment of potential changes to the consumer credit license fee regime	
Stage: Implementation	**Version:** Final	**Date:** 20 November 2009
Related Publications:		

Available to view or download at:

http://www.

Contact for enquiries: Dominic Middleton **Telephone:** 0207 211 8637

What is the problem under consideration? Why is government intervention necessary?

Under the Consumer Credit Act 1974 (as amended by CCA06) a fee is payable by all entities that apply for a consumer credit licence. The fee is intended to cover the costs of the Office of Fair Trading (OFT) when carrying out its functions under this Act. The OFT produce forecasts to match income to these costs, but a significant and unexpected reduction in applications has resulted in a deficit in 2008-9. Under current legal arrangements, it is not possible for the OFT to recover this deficit through licence fees paid in future years. If this deficit persists, the resources available to OFT will be reduced and its ability to carry out activities aimed at ensuring compliance with the Consumer Credit Act will be impaired. Intervention is therefore necessary to correct for this oversight in the existing legislation.

What are the policy objectives and the intended effects?

The Government's stated aim is that fee levels for statutory services should be set to recover the full cost of the service. Therefore, the objective is to ensure that the costs of OFT's compliance activities are fully funded by licence fee income. The solution is intended to give OFT the power to balance annual discrepancies between income and expenditure over a longer period and ensure that shortfalls, caused by variations in application numbers and type, can be met from fee income paid subsequently.

What policy options have been considered? Please justify any preferred option.

Three options have been considered for potential further action:

1. Do nothing
2. Introduce new secondary legislation (the Consumer Credit Act (Fees) 2009 Order)
3. Amend existing primary legislation (Consumer Credit Act 1974 (amended by CCA 2006))

Option 2 is the preferred option, as it addresses the problem identified above, but in a shorter timeframe than option 3.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Any increase in credit licensing fees required within this timeframe will be subject to a separate approval process. A fundamental review of the credit licensing fees structure will be undertaken in early 2010.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

> ***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

Signed by the responsible Minister:

Kevin Brennan

.... Date: 30/11/2009

Summary: Analysis & Evidence

Policy Option: Introduce new secondary	Description: Introduction of Consumer Credit Act (Fees) Order 2009

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off	**Yr**	
£ Unknown	N/	None anticipated - although there is potential for an increase in consumer credit licence fees to recover deficits (as an illustration, recovery of the existing deficit would imply a cost of less than £1 per licensed business when applied to the licensed population)
Average Annual Cost (excluding one-off)		
£ Unknown		**Total Cost** (PV) **£ Unknown**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yr**	
£ Unknown	N/	Consumer detriment avoided by maintaining appropriate levels of compliance to ensure only fit and competent persons are permitted to engage in consumer credit business
Average Annual Benefit (excluding one-off)		
£ Unknown		**Total Benefit** (PV) **£ Unknown**

Other **key non-monetised benefits** by 'main affected groups'

Key Assumptions/Sensitivities/Risks Variations in application numbers and type could lead to cuts in expenditure, which risks the potential for significant consumer detriment. A significant licence fee increase required solely to cover past deficits is unlikely. As such the risk of exit for smaller providers or for increased costs to be passed on to consumers (e.g. through higher interest rates or fees for credit-related services) is low.

Price Base	Time Period	**Net Benefit Range** (NPV) **£ Unknown**	**NET BENEFIT** (NPV Best estimate) **£ Unknown**

What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	2010
Which organisation(s) will enforce the policy?	OFT
What is the total annual cost of enforcement for these	£ 10 million
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	N/A

What is the value of the proposed offsetting measure per		£ N/A		
What is the value of changes in greenhouse gas emissions?		£ N/A		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)						(Increase -
Increase	£ N/A	Decreas	£ N/A	**Net**		**£** N/A

Key: **Annual costs and benefits: Constant**

Summary: Analysis & E	
Policy Option: Amend primary legislation	**Description: Amendment of Consu Consumer Credit Act 2006)**

COSTS			
ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'	
One-off	**Yr**	None anticipated - although there is potential for an increase in consumer credit licence fees to recover deficits (as an illustration, recovery of the existing deficit would imply a cost of less than £1 per licensed business when applied to the licensed population)	
£ Unknown	N/		
Average Annual Cost (excluding one-off)			
£ Unknown		**Total Cost** (PV)	**£ Unknown**
Other **key non-monetised costs** by 'main affected groups'			

BENEFITS			
ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'	
One-off	**Yr**	Consumer detriment avoided by maintaining appropriate levels of compliance to ensure only fit and competent persons are permitted to engage in consumer credit business	
£ Unknown	N/		
Average Annual Benefit (excluding one-off)			
£ Unknown		**Total Benefit** (PV)	**£ Unknown**
Other **key non-monetised benefits** by 'main affected groups'			

Key Assumptions/Sensitivities/Risks Variations in application numbers and type could lead to cuts in expenditure, which risks the potential for significant consumer detriment. It is likely that amendment of primary legislation would require a significantly longer timescale than introducing a fees order. A significant licence fee increase required solely to cover past deficits is unlikely. As such the risk of exit for smaller providers or for increased costs to be passed on to consumers (e.g. through higher interest rates or fees for credit-related services) is low.

Price Base	Time Period	**Net Benefit Range** (NPV) **£ Unknown**	**NET BENEFIT** (NPV Best estimate) **£ Unknown**

What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	After 2010
Which organisation(s) will enforce the policy?	OFT
What is the total annual cost of enforcement for these	£ 10 million
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	N/A

What is the value of the proposed offsetting measure per			£ N/A		
What is the value of changes in greenhouse gas emissions?			£ N/A		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large	
Are any of these organisations exempt?	No	No	No	No	

Impact on Admin Burdens Baseline (2005 Prices)					(Increase -	
Increase	£ N/A	Decreas	£ N/A	**Net**	**£** N/A	

Key: **Annual costs and benefits: Constant Prices**

Overview

1. Under current legal arrangements, the OFT is not permitted, when setting its consumer credit licence fee, to include any element to recover past deficits incurred through the operation of the credit licensing regime. This means that, in the event of a deficit, the credit licensing regime will not be run on the basis of full cost recovery. Also, short term variations in the number and type of credit licence applications risk a reduction in enforcement expenditure, which introduces the potential for significant consumer detriment.

Background

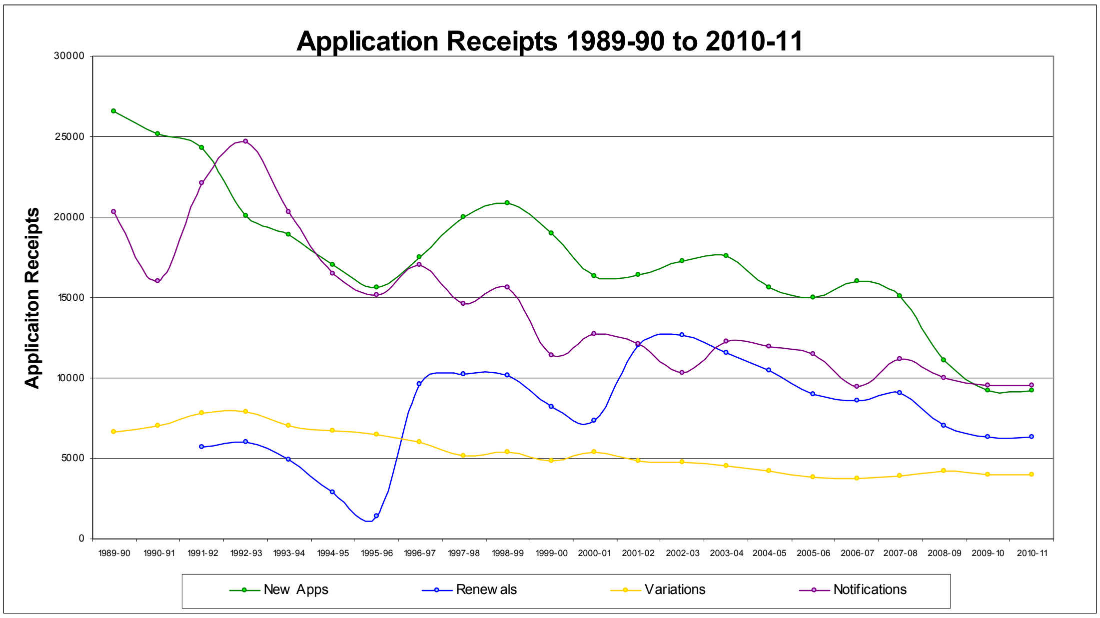
2. The credit licensing regime was established under the Consumer Credit Act 1974 (the Act) to deliver consumer protection in the credit market. This is achieved through a positive licensing regime which establishes and monitors the fitness of applicants to hold a credit licence. Licensing is the key regulatory mechanism by which standards of behaviour by credit businesses in their dealings with consumers are maintained.
3. Licensable activities involve participants in virtually all business sectors. Subject to some limited exceptions, a fee is payable to the OFT for any application for a credit licence, regardless of business sector[2].
4. Licence applications[3] can be made by sole traders, partnerships (including limited liability partnerships), and incorporated and unincorporated bodies. After a licence has been issued, the OFT continues to monitor the fitness of licence holders and has the power to revoke a licence. The licensed population is large, with 106,000 extant licences, as at October 2009[4]. The OFT undertakes a wide range of actions to facilitate and encourage a high level of compliance, rather than simply relying on action against those who are in breach.
5. The Consumer Credit Act 2006 (CCA06) made fundamental changes to the licensing regime. This required the OFT to take a more active role in considering an applicant's suitability (fitness) to enter the market and their credit competence in undertaking particular types of business. Additionally, the Act granted the OFT new powers (requirements and financial penalties) with which to address concerns with licence holders. At the same time that CCA06 was implemented, the credit licensing regime was moved to a self-funding model – that is, all of OFT's costs must be recovered through fees.
6. Since April 2008, credit licences have been issued for an unlimited duration. However, licences issued prior to April 2008 were valid for 5 years. After 2013, the OFT intends to move towards an annual maintenance charge system, though this will be the subject of a separate review of credit licence fees.

[2] If a business is made up of several different legal persons/entities, they must have separate licences
[3] Including applications for new licences, renewals and variation to a licence
[4] Given that licences were issued for 5 years up to March 2008, the OFT cannot vouch that all licensed persons continue to conduct licensable business

The issue

7. The licensing fee level is intended to ensure that all consumer credit activity is cost-neutral, so that income generated through licensing equals expenditure. The major factors to consider when setting the licence fee are the number of anticipated applications across the year (receipts), which drive income, and the level of work required ahead of issuing the licences and to ensure licensed persons are continuing to act in a fit and competent manner (expenditure).

8. New licence applications and renewals in 2008-09 were significantly below the expected level[5], due to the downturn in the credit market, combined with businesses reconsidering whether they engaged in licensable activities, especially in high-risk activities, given the increased rigours introduced by the CCA06. As a result of this decrease in applications, shown in the chart below, income in 2008-9 was only £9.2m compared to a forecast (on a self-funding basis) of £11.5m.



Source: OFT

9. At the same time, the more rigorous regime introduced under CCA06 has meant that expenditure to achieve compliance has increased. There has been a significant increase in the percentage of applications received for high-risk categories of licensable activities[6] (for example, debt-related[7] and sub-prime secured credit applications). This requires the provision of considerably more information to OFT and in many cases an on-site inspection. This trend towards higher-risk categories has meant that expenditure on licensing activity had to be maintained at a suitable minimum level to discharge statutory obligations, even given the lower application numbers.

10. Substantial efforts have been made to reduce the operating costs of the regime, with expenditure reduced from £11.5m to £9.7m in 2008-9. While some of these cuts could be maintained as efficiency savings going forward, others are not sustainable over the medium term if the regulatory regime is to remain effective.

11. Overall, taking into account additional deferred income from 2007-8, this has led to a deficit for the OFT in operating the credit licensing regime of £98,000 in 2008-9. A discrepancy between spend and income can only be addressed through a formal fees review process. Fees were increased, in agreement with HM Treasury and BIS, by 42% in May 2009. However, the fee-raising powers within CCA06 do not explicitly allow the recovery of previous deficits.

[5] There were 21,800 applications in 2008-9 compared to a forecast of 27,700. Applications received in the previous year (2007-08) stood at 28,150.
[6] 35% of applications were high-risk, as per the OFT risk model
[7] Such as collection, purchase and commercial debt counselling

12. As a result of OFT incurring a deficit on its credit licensing regime, resources are effectively being diverted away from other OFT activities. This means the licensing regime is not being run on a full cost recovery basis as required, but partly funded by the taxpayer. Furthermore, if no action is taken and receipts (income) fall below those anticipated, the OFT will have no choice but to cut costs, leading to lower levels of activity aimed at ensuring compliance[8] with the act and the potential for significant consumer detriment[9].

Objectives

13. The objective is to ensure that the OFT is able to run the consumer credit licensing regime on a full cost recovery basis. The Government believes the policy of Full Cost Recovery should apply in respect of the consumer credit licensing regime. Given the large numbers within the field, the wide scope of their business activities and fluctuating prevailing economic conditions, it is not possible to predict licensing income with the degree of accuracy required to guarantee a perfect match against expenditure over an annual cycle.

14. To address this, the OFT should have the power to balance out discrepancies between income and expenditure over a longer period. This will allow shortfalls, caused by inevitable variations in application numbers and type, to be met from fee income paid subsequently.

Options

15. Apart from a 'do nothing' scenario, there are two further options being considered that would allow the OFT to operate the consumer credit licensing regime on a full cost recovery basis, by allowing recovery of past deficits – option 2 is the introduction of secondary legislation (through the Consumer Credit Act (Fees) 2009 Order), and option 3 is the amendment of existing primary legislation (the Consumer Credit Act 1974, as amended by CCA06).

16. The preferred option is option 2 – that the Consumer Credit Act (Fees) Order is laid – as this allows for the maintenance of a sustainable credit licensing regime that is delivered on a full-cost recovery basis. The same overall objective is met through option 3 but this will require a significantly longer timescale.

Option 1: Do Nothing

17. The status quo means the credit licensing regime continues to be vulnerable to fluctuations in licence applications. When expenditure unavoidably exceeds income (as in 2008-9), OFT is unable to recover the deficit that has been incurred. This could lead a shortfall in income and the need to reduce action aimed at ensuring compliance, which would result in significant consumer detriment, as identified above. In addition, the consumer credit licensing regime cannot run on the basis of full cost recovery,

Option 2: Introduce secondary legislation – the Consumer Credit Act (Fees) 2009 Order

18. Under this option, the Consumer Credit Act (Fees) 2009 Order is laid. This will allow the OFT to set fees to recover previous deficits and will ensure that the credit regime operates with an appropriate level of action aimed at ensuring compliance on the basis of a consistent risk assessment. The OFT will continue to prepare high-quality forecasts of costs for each financial year and seek to set fees in order to match income and expenditure in each financial year.

19. By laying this Order, this does not automatically mean that there will be an increase in consumer credit licensing fees. The power that the Order grants to OFT is that, in setting the level of consumer credit licence fees, it will be allowed to take into account the recovery of past deficits.

---

[8] Such as reduced checks on applicants, leading to the potential for the fitness and competency of some applicants for high-risk activities (e.g. debt collection, secured lending) to be left unexplored

[9] For example, it could allow entry to the market to those who would wish to take advantage of vulnerable consumers. Inadequate deterrence would also be likely to result in activities which might worsen the position of financially distressed consumers.

20. There are no explicit costs and benefits to be evaluated under this option, as it merely grants the power to be able to set fees in order to recover deficits.
21. As an illustrative example, if the current deficit (of £98,000) were to be recovered through an increase in the licence fee – applied equally across all licence holders – this would imply a cost per active licence holder of less than £1 each.
22. Given the scale of this increase, it is unlikely that such action would result in any unintended adverse consequences – for example, licence fees increasing to the point of becoming prohibitively expensive for smaller providers, which may result in exit and a reduced degree of competition, or costs being passed on to consumers in the form of more expensive consumer credit services.
23. The commensurate benefits of being able to recover past deficits would be to ensure that the credit licensing regime was run on a full-cost recovery basis. There would also be a much reduced risk of having to forego action aimed at ensuring compliance, ameliorating the subsequent potential for consumer detriment.

Option 3: Amend primary legislation – i.e. Consumer Credit Act 1974 (amended by CCA06)

24. Under this option, the Consumer Credit Act 1974 (as amended by CCA06) would be revised explicitly to grant the OFT fee-raising powers that include the recovery of past deficits. Although this has the same net effect as option 2, up to 2013 at least, such action would require amendment to primary legislation and thus implementation may take substantially longer.

Risks

25. As set out above, any fees increase required solely to allow recovery of the existing deficit is unlikely to be significant and therefore result in the unintended consequences set out above under option 2. In all cases, fee increases for credit licensing are subject to the agreed approval process.
26. Under current legal arrangements, it is not possible for the OFT to recover deficits through licence fees paid in future years. This means that, in the event of a deficit, the credit licensing regime will not be run on the basis of full cost recovery. Further, short term variations in application numbers and type could lead to significant cuts in expenditure, which risks the potential for significant consumer detriment.

Enforcement

27. The OFT will continue to be responsible for the collection of consumer credit licensing fees. This continues to be in line with Hampton principles.

Implementation

28. The order will ensure that the credit licensing regime achieves full cost recovery over the transition period to 2013. Any increase in credit licensing fees required within this timeframe will be subject to the standard approval process.

Monitoring and evaluation

29. As set out in the recent BIS White Paper[10], a fundamental review of the credit licensing fees structure will be undertaken in early 2010, with any new fee structure formally introduced in 2011 (after trialling in 2010-11).

[10] 'A Better Deal for Consumers: Delivering Real Help Now and Change for the Future' (2009)

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	No
Rural Proofing	No	No

Annexes

Competition Assessment

No impact. The order will not directly or indirectly limit the number or range of suppliers, their ability to compete or reduce their incentives to compete vigorously.

Historic fees increases have resulted in a drop off in applications that exhibit a higher percentage of 'sole trader' than other applicants. 'Sole traders' may have applied for credit licences in the past, irrespective of actual need, given the very low cost involved. The higher drop off in 'sole traders' applications is partly due to them reconsidering the need for a credit licence given the increased cost of an application. Importantly, the most recent fees increase within May 2009 resulted in 'sole trader' and other applicants dropping off by a similar percentage however.

Any licence fee increase solely to cover a deficit is likely to be very small. Recovery of the existing deficit would imply a cost of less than £1 per licensed business, when applied to the entire licensed population. The potential for an impact on competition is thus very low, especially in the light of the most recent fees increase.

Small Firms Impact Test

No impact. The current licensing fees regime differentiates between applicants, depending on whether they are 'sole trader' or 'other'. There are approximately 37,000 'sole trader' and 69,000 'other' licence holders within the current population of 106,000 licence holders. 'Sole trader' applicants pay a reduced fee (£330) compared to 'other' applicants (£820) and this differential pricing will not be amended by the order[11]. However, the entire credit licensing fees structure will be reviewed as set out in the recent BIS White Paper. The impact on small businesses will form a key element of that review.

Equalities Impact Test

The Equalities Impact tests have been considered in light of all the information available. However, information on race, disability and gender is not specifically collected at the point of application and is thus not available for the licensed population. Given the size of fee increase necessary solely to address a deficit, no significant impact is anticipated in any event. Further, the order will not introduce additional constraints or barriers to entry to the credit market which have the potential to introduce inequalities, within a particular group for instance. The order will neither target nor unduly impact any specific 'group' in pursuit of its aim.

---

[11] The fees quoted here exclude the Financial Ombudsman Service (FOS) levy. This is collected by OFT but apart from a very small charge to cover our administration costs, the OFT simply passes this levy straight across to the FOS.