Application made by the Solicitors Regulation Authority Board to the Legal Services Board under Part 3 of Schedule 4 to the Legal Services Act 2007, for the approval of changes to regulatory arrangements relating to the regulation of consumer credit activities

A. Summary

1 This application is made by the Solicitors Regulation Authority (SRA) to the Legal Services Board (LSB) for approval of changes to the SRA's regulatory arrangements, to allow SRA-authorised firms to carry on consumer credit activities under Part 20 of the Financial Services and Markets Act 2000 (FSMA).

B. Background

2 Regulation of consumer credit activities transferred from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA) on 1 April 2014. Consumer credit activities are a part of normal business practice for many financial institutions and businesses, and often form part of the work of SRA-authorised firms. As a consequence of the transfer of regulation, the SRA considered whether arrangements should be put in place governing how SRA-authorised firms carry on consumer credit activities. These arrangements needed to meet the approval of the FCA.

3 In October 2014, we consulted on our proposal to withdraw from the FCA's Designated Professional Body (DPB) regime for the purposes of consumer credit activities. The decision to consult on this proposal was made because it appeared as if we would be required to largely mirror the FCA's regulation. The FCA's model of regulation is designed for financial services, including consumer credit activities, whereas our approach to regulation is designed for the legal services market where the issues and risks are different. We have increasingly focused on developing and delivering regulation that is proportionate to the nature of an entity, the services it provides and the associated risks; this approach has generally led to the removal of detailed and prescriptive rules. By contrast, the FCA's regulatory arrangements for consumer credit impose detailed obligations on those it regulates. At the time that we consulted, it was difficult to see how two such different approaches could be reconciled to provide coherent and consistent arrangements.

4 The impact of this proposal, if implemented, was that SRA-authorised firms carrying on any regulated consumer credit activities would need to apply to the FCA for authorisation rather than being able to rely on Part 20 of FSMA.

5 Responses to the consultation highlighted detriment to firms and consumers in relation to our proposal and we decided that there was benefit in us remaining within the Part 20 regime. We worked closely with the FCA in

developing proposals for proportionate regulatory arrangements. We identified the consumer credit activities that we considered were central to the delivery of legal services and the kinds of activities which we believed were distinct and specialist consumer credit services.Our aim in developing our proposals was for SRA-authorised firms to be able to continue to carry on, consumer credit activities that are central to the delivery of legal services but firms wishing to carry on those distinct and specialist services would need to be authorised by the FCA.

C. Details of the SRA's current regulatory arrangements

6 Following the transfer of regulation of consumer credit activities from the OFT to the FCA transitional arrangements were put in place to facilitate this transfer of regulation of consumer credit activities. Changes were made to the SRA Financial Services (Scope) Rules 2001 to allow SRA-authorised firms to continue to carry on consumer credit activities without being regulated by the FCA. This was provided that they could meet the conditions set out in Part 20 of FSMA and comply with the relevant legislative provisions and OFT guidance that were in force immediately before 1 April 2014[1]. The transitional arrangements were approved by the Legal Services Board (LSB) on 19 March 2014 and end on 31 March 2016. A point to note is that under the OFT's group licence regime, SRA-authorised firms posed very little risk and very few issues were ever identified

Financial services

7 Under Part 20 of FSMA, SRA-authorised firms are able to carry on certain regulated activities without having to be authorised by the FCA. As a DPB, the SRA is required to have rules that govern the carrying on of these activities; these are the SRA Financial Services (Scope) Rules 2001 (Scope Rules) and the SRA Financial Services (Conduct of Business) Rules 2001 (COB Rules). In all circumstances, SRA-authorised firms must comply with the SRA Principles 2011 and the Outcomes set out in the SRA Code of Conduct 2011, therefore, ensuring adequate consumer protection.

8 The purpose of the Scope Rules is to set out the scope of the FSMA regulated activities which may be undertaken by SRA-authorised firms that are not authorised by the FCA. These rules:

(i) prohibit firms which are not regulated by the FCA from carrying on certain regulated activities;
(ii) set out the basic conditions which those firms must satisfy when carrying on any regulated activities; and
(iii) set out other restrictions on regulated activities carried on by those firms.

9 The COB Rules regulate the way in which firms carry on FSMA regulated activities.

[1] as set out in Rule 1.3R of the FCA's Consumer Credit sourcebook (CONC)

D. Nature and effect of the proposed alterations to the SRA's regulatory arrangements

10 The SRA Amendment to Regulatory Arrangements (Consumer Credit) Rules [2015], which are set out in Annex 1, were made by the SRA Board on 16 September 2015 to come into effect on 1 April 2016, subject to approval by the FCA and the LSB. The FCA approved these rules on 3 November 2015.

11 The overarching aim of our arrangements is to ensure they are proportionate and targeted so that firms can continue, under SRA regulation, to carry on the consumer credit activities that are central to their legal practice. We have set out certain activities that we consider to be distinct and specialist consumer credit services that should be regulated by the FCA, as the specialist financial services regulator with the appropriate experience and expertise. These activities form the list of prohibited activities and restrictions in the Scope Rules and is consistent with our current approach to the regulation of financial services. In identifying such prohibitions and restrictions we have taken into account the relevant EU Directives and the regulatory requirements set out in the FCA's Consumer Credit sourcebook (CONC) as these are useful indicators of where activities are considered to be higher risk and would be more appropriately authorised by the FCA.

12 The prohibited activities include, for example, entering into a regulated credit agreement as lender (except where the regulated credit agreement relates to the payment of disbursements or professional fees). The restrictions include, for example, taking any article from the client in pledge or pawn as security for a transaction (pawn broking).

13 The changes to the SRA Handbook will allow firms to carry on consumer credit activities under Part 20. Firms will be able to continue to provide consumer credit services to consumers so long as they comply with the Scope Rules and the COB Rules.

14 Amendments to the COB Rules have been made in order to achieve the appropriate levels of consumer protection as set out in CONC, or as a result of requirements prescribed in legislation such as the EU Credit Agreements Directive (2008/48/EC). We tried to make sure that any changes to our rules in relation to the carrying on of permitted consumer credit activities were made only where necessary and wherever possible avoided unnecessary duplication of existing SRA requirements.

15 The effect of these rules will therefore, be to:

(a) prohibit certain credit-related regulated activities and impose restrictions on other credit related regulated activities, and;

(b) introduce certain requirements in relation to credit-related regulated activities intended to makesure that SRA-authorised firms:

- communicate effectively, in a manner which is fair and transparent;
- appropriately assess clients' creditworthiness, and provide clients with adequate explanations to enable them to make informed decisions;
- are transparent when engaging with third parties and when assigning rights under an agreement;

- provide clients with a degree of flexibility with regards to payments due in respect of two or more credit agreements; and
- have regard to the SRA's guidance on credit-related activities.

16 A change is also being made to the SRA Code of Conduct 2011 to include 'regulated credit agreements' under the requirements set out in indicative behaviour 6.1. This provides that introductions to third parties will only be made where in the best interests of the particular client and the agreement is suitable for the needs of that client.

17 Finally, we have introduced new defined terms into the SRA Handbook Glossary 2012. The majority of the defined terms have been taken from the FCA Handbook Glossary and adapted where necessary.

18 The proposed additions to the rules will need to be read in conjunction with the other conditions set out in the Scope Rules and the COB Rules that will continue to apply. As mentioned previously, when considering the Scope and COB Rules firms should continue to have regard to the SRA Principles 2011 and other relevant Outcomes contained in the SRA Code of Conduct 2011, such as those relating to client care and the management of their business. It is not envisaged that SRA-authorised firms will have to spend extra resources or finances in adjusting their business practices.

19 SRA-authorised firms wanting to carry on 'prohibited' activities or work outside the restrictions would have to be authorised by the FCA in order to do so. FCA authorisation would mean that SRA-authorised firms would no longer be able to benefit from the Part 20 regime in relation to any other FSMA regulated activities (for example, insurance mediation activities). This is because FSMA prevents a firm from being authorised by the FCA and carrying on exempt regulated activities under Part 20 at the same time.

20 We will also be publishing the attached guidance (Annex 4) that will complement the rule changes. The guidance is made up of three parts: overarching consumer credit guidance, debt advice guidance and debt collection guidance. It provides clarity for firms about how the SRA Principles and Outcomes in the Code will apply in the context of consumer credit activities. It also provides illustrative examples of practices/behaviours that we consider could result in a breach of the Principles or a failure to achieve the Outcomes.

E. Rationale for amendments

21 In designing our regulatory framework for the regulation of consumer credit activities, we wanted to make sure that SRA-authorised firms would be able to carry on consumer credit activities central to the delivery of legal services subject to proportionate and targeted regulatory arrangements under Part 20 of FSMA. This required changes to be made to the Scope and COB Rules.

F. Statement in respect of the Regulatory Objectives

22 Our position with regards to the regulation of consumer credit activities has been led by the transfer of regulation from the OFT to the FCA, as reflected in the relevant provisions of FSMA. Our comments on the regulatory objectives

therefore relate to our policy as a DPB in implementing the transfer of regulation.

23 The SRA Board is satisfied that its proposals for implementing the transfer of regulation are compatible with the regulatory objectives and represent the most appropriate means of meeting these objectives whilst fulfilling our obligations under FSMA.

24 The SRA Board has not identified an adverse effect on any of the regulatory objectives as a result of the proposed amendments.

Protecting and promoting the public interest

25 Our arrangements benefit the public interest by enabling consumers to safely access consumer credit activities central to the delivery of the legal services provided by those that we regulate. By providing arrangements that are targeted and proportionate, we ensure that the restrictions imposed by and cost of regulation do not outweigh the benefits for the public.

Supporting the constitutional principle of the rule of law

26 These proposals will have a neutral impact on the constitutional principle of the rule of law.

Improving access to justice

27 Our arrangements allow for SRA-authorised firms to consider how best to structure their business and continue to provide consumer credit activities that are central to the legal services they provide. Our view, supported by consultation respondents, is that the arrangements will not place a significant barrier to providers offering consumer credit activities ancillary their legal practice. This will have a positive impact on access to justice, particularly for consumers unable to pay for legal services up front without financing arrangements that are regulated consumer credit activities e.g. deferred payments. Responses to an earlier consultation identified a risk that some firms, particularly small firms and sole practitioners, may be forced out of the market or may cease to provide consumer credit activities central to their legal services if dual FCA regulation was required in order to do so. Our arrangements minimise this risk.

Protecting and promoting the interests of consumers

28 We consider that the arrangements will have a positive impact on the interests of consumers. As set out above, they allow SRA-authorised firms to continue to provide consumer credit activities to their clients. At the same time the arrangements offer appropriate consumer protection. The FCA has approved our arrangements on the basis that they provide equivalent protection to their own rules, while targeting those activities that we understand firms engage in as part of their legal practice.

Promoting competition in the provision of services such as are provided by authorised persons

29 The proposal will promote competition in the provision of legal services by providing a proportionate and targeted regulatory regime that does not add

unnecessary costs or restrictions to SRA authorised firms that would negatively impact on their competitiveness in terms of price or services offered.

Encouraging an independent, strong, diverse and effective legal profession

30 The obligations to encourage an independent and strong legal profession are neutral in relation to this policy.

Increasing public understanding of the citizen's legal rights and duties

31 The proposals will have a neutral impact.

Promoting and maintaining adherence to the professional principles

32 The proposals will have a neutral impact.

G. Statement in respect of the Better Regulation Principles

33 The SRA considers that the proposed alterations fulfil our obligation under section 28 of the Legal Services Act to have regard to the Better Regulation Principles.

34 The SRA's regulatory arrangements are proportionate and targeted and they fulfil our obligations as a DPB. The changes, in most cases, avoid the need for dual regulation by both the SRA and the FCA.

35 We note the obligations under section 54 of the Legal Services Act 2007 aimed at avoiding regulatory conflict and duplication between approved regulators and external regulatory regimes. With this in mind we consider it to be particularly important to ensure transparency regarding which regime applies in what circumstances and a clear distinction between the aims and purposes of each. The regulatory arrangements seek to achieve this aim by ensuring that SRA regulation is focussed on the provision of legal services and activities central to those services, and reserves to the FCA activities which are of a specialist financial nature.

36 The changes also ensure an efficient and effective use of SRA resource.

H. Statement in relation to desired outcomes

37 The SRA’s desired outcome is that SRA-authorised firms comply with the Scope and COB Rules if they are involved in the carrying on of credit activities as an exempt professional firm. The SRA continues to ensure that it has in place a regulatory framework which isproportionate and targeted.

I. Stakeholder engagement

38 The second consultation on consumer credit was launched on 26 June 2015 and closed on 7 August 2015. Prior to the launch of the consultation we shared our draft proposals with the Law Society, the City of London Law Society and the SRA's small firms virtual reference group. We also talked to a number of firms delivering consumer credit activities. Feedback informed our

proposals - highlighting issues requiring further consideration and detail that needed to be set out in the consultation.

39 As part of the consultation launch, we published a series of questions and answers to help inform responses and in conjunction with information which had already been published on the SRA website.

40 On 16 July 2015, a webinar was held in which we discussed the consultation proposals and sought views from delegates on whether we had achieved the right balance. In response, 88% of those responding agreed that the prohibited activities were not central to the delivery of legal services and, therefore, appropriate for firms carrying on any such activity to be regulated by the FCA and 81% of respondents felt that the restrictions would not impact on their ability to deliver services to their clients.

41 The webinar also gave an opportunity for delegates to ask further questions to inform their response to the consultation and consider the impact on their firms. The question and answers published with the consultation were updated shortly after the webinar to address the issues raised.

42 In response to the consultation, a total of 31 responses were received from stakeholders, including individual solicitors and firms of varying sizes, the Law Society of England and Wales, local Law Societies, the Legal Ombudsman and the Legal Services Consumer Panel.

43 The vast majority of respondents supported our proposals. Most considered that the SRA had reached the right balance in discussions with the FCA by proposing to regulate only those consumer credit activities that were considered to be central to the delivery of legal services. In response to the proposal for certain consumer credit activities to be prohibited and for restrictions to apply, the majority of responses received agreed that the position that had been reached was sensible and appropriate.

44 The Legal Services Consumer Panel questioned whether our arrangements could contain greater prescription relating to vulnerable consumers. Our guidance (Annex 4) highlights the need for SRA-authorised firms to be able to identify whether the client is vulnerable and to deal with vulnerable clients appropriately. We currently undertaking a wider piece of work considering risks to vulnerable consumers in relation to the provision of any services being offered by those that we regulate. This may include identifying where consumers should be signposted to different sources of help. Outputs from this work, when completed, will apply consistently to consumer credit and other activities.

45 The subject of consumer credit has also been considered in e-newsletters SRA Update, which goes to everyone in the profession holding a mySRA account and other subscribers (totalling more than 200,000), and Compliance News, which is targeted specifically at Compliance Officers. We will continue to use this media to convey key messages.

46 We will continue our engagement to ensure that our final package is communicated to all SRA-authorised firms. Feedback from firms during the consultation exercise and from discussions with other stakeholders has identified the need for SRA-authorised firms carrying on consumer credit activities to be provided with support and guidance to aide compliance. Firms

have told us that the material already published on the SRA website, which includes a series of questions and answers, is helpful. We intend to continue helping firms through the production of an online toolkit which will include case studies and webinars as this remains as a complex and technical area. It is enviaged that the toolkit will provide SRA-authorised firms with a range of tools and resources to help them understand the regulatory requirements and deliver consumer credit services in a compliant way.

J. Statement in relation to impact on other Approved Regulators

47 We do not believe our proposals give rise to any conflict between any of the approved regulators.

K. Implementation timetable

48

Changes to the SRA's regulatory arrangements approved by the FCA and the LSB	November 2015
Publication of rules on SRA website	November 2015
Publication of guidance	November 2015
End of current transitional arrangements	31 March 2016
SRA rules and prohibitions come into effect	1 April 2016

L. SRA contact for matters relating to this application

49 If you have any queries in relation to this application please contact:

Jatinderpal Loyal
Policy Asssociate
Regulation and Education
Solicitors Regulation Authority
The Cube, 199 Wharfside Street, Birmingham, B1 1RN

Telephone: 0121 329 6673
Email: jatinderpal.loyal@sra.org.uk

Annex 1 SRA Amendment to Regulatory Arrangements (Consumer Credit) Rules [2015] (attached separately)

Annex 2 SRA Board paper on the regulation of consumer credit activities, 9 September 2015 (attached separately)

Annex 3 SRA supplemental Board paper on the regulation of consumer credit activities, 9 September 2015 (attached separately)

Annex 4 SRA Guidance Note

TITLE: SRA consumer credit guidance note

First published on: XX November 2015 and in force from 1 April 2016

Who should read this guidance?

This guidance is relevant to SRA-authorised firms involved in credit-related regulated activities carried out under Part 20 of the Financial Services and Markets Act 2000 (FSMA).

Part 20 allows SRA-authorised firms to carry on credit-related regulated activities without need for separate authorisation by the Financial Conduct Authority (FCA). An SRA-authorised firm that is also authorised by the FCA in relation to any activity cannot benefit from Part 20 and must obtain the appropriate FCA permissions to undertake credit-related regulated activities.

Scope of regulation

The scope of the credit-related regulated activities that SRA- authorised firms are permitted to carry on under Part 20 is set out in the SRA Financial Services (Scope) Rules 2001 (Scope Rules) and the activities that are credit-related regulated activities are defined in the SRA Handbook Glossary 2012. You need to be aware that a breach of any of the Scope Rules, including undertaking regulated activities that are only allowed to be carried on by FCA-authorised firms, may be a criminal offence under FSMA.

You are also reminded that you may make financial promotions only if the financial promotion has been approved by an FCA-authorised person. You are still able to make exempt financial promotions without requiring the approval of an FCA-authorised person; these are financial promotions which are exempt under the Financial Promotions Order[2].

What regulatory arrangements apply?

You must, at all times, ensure compliance with the SRA Principles 2011 and Outcomes set out in the SRA Code of Conduct 2011 (the Code).

In addition, when carrying on credit-related regulated activities, you must comply with the SRA Financial Services (Conduct of Business) Rules 2001 (COB Rules), and in particular Appendix 2 of the COB Rules. .

This formal guidance forms part of our regulatory arrangements relating to credit-related regulated activities and explains how the SRA Principles and Outcomes in the Code apply specifically to these activities. It also sets out examples of behaviours that will be expected of you when carrying on such activities.

The guidance reflects many of the FCA's rules which apply to FCA authorised firms engaged in credit-related regulated activities. The FCA's requirements in many parts replicate former guidance issued by the Office of Fair Trading which you were expected to have regard to under the group licence regime and during the transitional period when carrying on credit-related regulated activities.

[2] http://www.legislation.gov.uk/uksi/2005/1529/contents/made

You must have regard to this guidance when carrying on credit-related regulated activities. Failing to have regard to this guidance is a breach of the COB Rules and may indicate an issue of concern for investigation. We will take it into account when considering whether there has been a breach of our rules and whether any such breach requires us to take regulatory action.

This guidance does not set out an exhaustive list of all regulatory issues which might arise in this context, nor is it a substitute for the provisions of the SRA Handbook. It is your responsibility to ensure full compliance with the SRA Handbook at all times.

How is this guidance structured?

The guidance is organised into three sections and poses questions along the way that you will need to consider if you are involved in, or considering becoming involved in, the carrying on of credit-related regulated activities under Part 20.

Section 1 covers general behaviours that you must demonstrate (or avoid) when you undertake credit-related regulated activities - particularly focusing on the need to ensure that your client's expectations are managed and that you act in their best interests.

Section 2 relates to behaviours that will be expected of you if you offer debt advice services which could include debt counselling or debt adjusting or providing credit information services.

Section 3 reflects parts of the warning notice that the SRA published in 2013 and includes the need for you to have clear and effective policies and procedures when engaged in debt recovery work or dealing with debtors who may lack mental capacity.

Section 1 - Consumer credit and our expectations of you

Do I have the required competency to act?

Principle 5 requires you to provide a proper standard of service to your clients. Outcome 1.4 requires you to ensure that you have the necessary resources, skills and procedures to carry out your client's instructions. Outcome 1.5 requires you to ensure that the services you provide to clients are competent, delivered in a timely manner and take account of the client's needs and circumstances.

When acting on behalf of a client in respect of a credit-related regulated activity you should take steps to establish:

- the client's needs and circumstances; and,
- where appropriate their financial situation;

so that the potential impacts of a recommended course of action can be properly considered.

If you are dealing with a client or a third party in a different jurisdiction, you should take into account any differences in law and court procedure that may have an impact on their rights.

Are my client's expectations being managed?

Outcome 1.1 of the Code requires you to ensure that clients are treated fairly and Outcome 1.2 requires you to provide services to your clients in a manner which protects their interests.

When carrying on credit-related regulated activities you should ensure that you are in full agreement with your client as to the nature, scope and terms of the credit-related regulated activities which are or may be carried on and that you maintain a record of this agreement.

Outcome 1.13 requires you to ensure that clients receive the best possible information, both at the time of engagement and when appropriate as their matter progresses, about the likely overall cost of their matter.

Behaviours that are likely to demonstrate that your client's interests have been protected and that they have been treated fairly include (but are not limited to):

- not putting the client under pressure to accept terms of engagement that may not be in accordance with the client's wishes;
- setting out clearly and at an early stage the nature and cost of the services you provide and, where applicable, the identity of, and your relationship with, any relevant third party;
- where you charge different rates for professional services or any exempt credit-related regulated activities, this should be made clear to the client;
- not taking advantage of a client's lack of knowledge;
- bringing to the attention of the client how you will use his/her personal data and who that information might be shared with (in accordance with the Data Protection Act 1998); and
- setting out details of any relevant cancellation rights that may apply.

Am I acting in the best interests of my client?

Principle 4 requires you to act in the best interests of your client. When advising a client you should always treat your clients fairly (Outcome 1.1) and act in good faith and do your best for each of your clients (Outcome 1.2).

When assessing your compliance with Principle 4 and Outcomes 1.1 and 1.2 you may need to consider a range of factors, including whether you:

- identified whether the client was vulnerable and dealt with vulnerable clients appropriately (see also SRA Risk Outlook 2015);
- considered whether the client had the mental capacity to understand, remember and consider relevant information to make relevant decisions;
- considered whether the particular course of action was suitable for the client's needs and circumstances, including, where applicable, the client's financial position and ability to pay;
- provided sufficient information and explanations about all options available to the client, and how they operate and the reasons why a particular option is the most suitable for the client;
- made the client aware of the possible consequences and risks associated with an option;
- kept under review the operation and effectiveness of the chosen option and kept the client appropriately informed (when instructed on an on-going basis);

- ensured that you did not unfairly encourage, incentivise, induce or pressurise a client to make a decision without giving the client the time to consider the options (see also SRA guidance on inducements);
- ensured that you did not promote an option where you knew or had reason to believe that this would be unsuitable for the client in the light of their needs and circumstances;
- provided the client, upon request, with the name and address of any credit reference agency consulted;
- maintained client confidentiality (Outcome 4.1) and only shared financial or other information with the client's consent and in a transparent manner;
- did not mislead the client about the legal effect of a regulated credit agreement or debt solution.

When dealing with a credit broker or other permitted third party on behalf of a client you should have regard to Outcome 6.1 of the Code and take steps to ensure that the broker/third party is appropriately authorised by the FCA or exempt.

You should also ensure that when you engage with creditors or third parties, you do so in a transparent manner so that your client's interests are not adversely affected.

What do I need to consider when providing explanations and assessing creditworthiness?

The COB Rules require that, where you act as lender in relation to a proposed regulated credit agreement, you must provide an adequate explanation to enable the client to assess whether the proposed agreement is suitable to the client's needs and circumstances. This should cover in particular:

- any features of the agreement which may make the credit unsuitable for particular types of use;
- how much the client will have to pay periodically, and in total, under the agreement;
- any features of the agreement which may have a significant adverse effect on the client in a way which the client is unlikely to foresee;
- the principal consequences for the client arising from a failure to make payments under the agreement at the times required; and
- the effect of the exercise of any right to withdraw from the agreement and how and when this right may be exercised.

You should provide the client with an opportunity to ask questions about the agreement, and advise the client how to ask for further information and explanation.

The COB Rules also require a firm acting as a lender to assess the client's creditworthiness on the basis of sufficient information both before entering into a regulated credit agreement and before any significant increase in the amount of credit. In doing so, you should consider:

- the potential for the commitments to adversely affect the client's financial situation, taking into account information of which you are aware at the relevant time; and
- the client's ability to make repayments as they fall due over the life of the agreement and in a sustainable manner.

You should monitor the client's repayment record subsequently and take appropriate action where there are signs of actual or possible repayment difficulties. This should generally include providing contact details for not-for-profit debt advice bodies. You should not encourage a client to refinance a regulated credit agreement if the result would be that the client's commitments are not sustainable.

Contact with a client (or third party debtor) - what steps should I take?

Outcome 8.3 of the Code requires you to ensure that you do not make unsolicited approaches in person or by telephone. Outcome 2.1 says that you must not victimise or harass anyone in the course of your professional dealings.

When engaging with a client or third party debtor you should take steps to ensure that:

- all communications are balanced, comprehensive and easily understood;
- you do not send, or cause to be sent, any communication, for the purposes of marketing, after you have received a request from the person to stop doing so;
- you do not charge excessive or unreasonable costs; and
- you have regard to the person's wishes regarding the duration, timing and location of any meeting.

Do I need to signpost clients to alternative sources of help?

You should inform a client with debt difficulties that free and impartial information and assistance may be available from not-for-profit debt advice bodies and that the client can find out more by contacting the Money Advice Service.

Where you consider that your skills and resources do not meet the client's needs, you should also consider, where it is in the client's best interests, making a referral to or providing contact details for an appropriate debt advice provider or a not-for-profit organisation. Any referral to a third party should be made in compliance with the Outcomes set out in Chapter 6 of the Code.

You should also, where applicable, ensure that your client is aware that they may be eligible for help and assistance via the Financial Ombudsman Service.

Section 2 - Debt counselling, debt adjusting and credit information services

This section of the guidance note relates to debt advice work (debt counselling/adjusting) and the provision of credit information services.

The aim of Chapter 8 of the Code is to ensure that your publicity is not misleading and is sufficiently informative to ensure that clients and others can make informed choices.

Outcome 1.4 of the Code requires you to ensure that you have the resources, skills and procedures to carry out your clients' instructions so that their interests are protected. You should, therefore, set out clearly in any communication to a client the extent of the services you are able to offer.

What are credit information services and what should I take into account?

Providing credit information services includes circumstances where you are seeking information on behalf of a client about his/her financial standing (e.g. credit rating information), including asking a credit reference agency if it holds the information. You may also be asked to provide advice to the client on how to seek to alter, or secure the omission of, the information or how to seek to restrict the availability of the information.

The following behaviours may indicate that you have acted in breach of Principle 4 in failing to act in your clients' best interests or taking unfair advantage of them by:

- claiming that you will be able to remove negative but accurate information from a client's credit file, including entries concerning adverse credit information and court judgments;
- misleading a client about the length of time that negative information is held on the client's credit file or any official register;
- claiming that a new credit file can be created, such as by the client changing address;
- implying that you will be able to guarantee a favourable outcome; or
- using an offer of credit information services in order to promote other services to the client.

Advice and agreeing solutions - what is expected of me?

You should take steps to ensure clients are aware of the scope of your advice and the potential risks of a proposed debt solution so that an informed decision can be made (Outcome 1.12).

Any recommended options should be in the best interests of the client. You should make clear the actual or potential advantages, disadvantages, costs and risks of each option available to the client with any conditions that apply for entry into each option and which debts may be covered by each option. You should also seek to ensure that the client understands the information and explanations provided.

To ensure that your client is treated fairly (Outcome 1.1) you should where appropriate, before giving advice or a recommendation on a particular course of action in relation to your client's debts, carry out a reasonable and reliable assessment of:

- the client's financial position (including the client's income, capital and expenditure);
- the client's personal circumstances (including the reasons for the financial difficulty, whether it is temporary or longer term and whether the client has entered into a debt solution previously and, if it failed, the reason for its failure); and
- any other relevant factors (including any known or reasonably foreseeable changes in the client's circumstances such as a change in employment status or family circumstances).

You should inform your client, where applicable, that certain options (for example, entering into an individual voluntary arrangement or a debt relief order) will or may result in details being entered on a public register and may have an adverse effect on the client's credit rating.

I have been asked to provide a financial statement on behalf of a client - what do I need to keep in mind?

If you are asked to prepare a financial statement on behalf of a client to be sent to a creditor or a permitted third party, you should ensure that:

- the financial statement is accurate, clear and realistic and the client has confirmed its accuracy;
- you have taken reasonable steps to verify information contained in the statement or have sought explanations from the client where appropriate;
- the statement sets out any fees or charges being made by you in relation to the activity (and a revised statement is sent if these change subsequently affecting payments by the client);
- the client consents to the statement being shared with the creditor or third party and has confirmed that the statement is accurate; and
- the statement is shared with the creditor or third party, and the client, as soon as possible after the accuracy of the statement has been confirmed.

You should also ensure that you take reasonable steps to verify the client's identity, income and outgoings and seek explanations where necessary.

Can I advise a client to make changes to contractual payments?

If you advise a client not to make a contractual repayment or to cancel any means of making such a repayment before any debt solution is agreed or entered into, you should be able to demonstrate the advice is in the client's best interests (Principle 4). This includes where you advise a client to switch debt solutions and adopt an alternative. Any change to a debt solution should only be made where the client has consented and understands the impact of any such change. You should ensure that all risks and consequences have been explained (Outcome 1.12).

If you advise a client to make changes to contractual payments, you should advise the client to notify any creditors without delay and to explain that the client is following your advice to this effect.

If you have advised a client not to make contractual repayments (in full or in part) or to cancel the means of making such payments or not to make repayments necessary to meet interest and charges accruing, you should take steps to inform the client accordingly if it becomes clear that this course of action is not producing effects in the client's best interests (Principle 4).

Can I charge for debt advice and related services?

Yes. When agreeing fees/charges for your services, you should ensure that the client does not pay all or part of your fees in priority to making any repayments that are due to a creditor and that the fees/charges do not undermine your client's ability to make significant repayments to a creditor.

You should take steps to ensure that, if you hold money on behalf of the client, you distribute that money promptly, following negotiating a settlement with the client's creditors or a third party.

If you identify that advice provided by you to the client was incorrect or was not appropriate to the client, you should not charge an additional fee for further or revised advice. Where appropriate should offer a refund to the client for any losses incurred.

Section 3 - Debt collection

This section of the guidance note relates to debt recovery work including arrangements between firms and debt recovery businesses.

What are the key risks and issues?

The SRA in its review of firms involved in debt recovery and the arrangements they have in place with debt recovery businesses has identified some key risks and issues. These include:

- misleading or aggressive correspondence sent by or on behalf of the firm;
- letters before action being sent without adequate supervision;
- firms putting their independence at risk by the nature of the arrangements with and/or their reliance upon a debt recovery business;
- unfair treatment of clients or third party debtors in arrears or financial difficulties;
- ignoring or disregarding a third party's claim that a debt has been settled or is disputed and then continuing to make demands for payment without providing clear justification and/or evidence as to why the third party's claim is not valid;
- commencing proceedings in the wrong jurisdiction;
- failing to establish the true identity of the debtor or the amount of the debt owed;
- failing to make clear the purpose of any contact with the debtor;
- taking or threatening disproportionate action against a client or third party in arrears or default or action which it may not be permissible to take;
- failing to provide clients or third party debtors (or their representatives) with information about the amount of any arrears and the balance owing;
- failing to inform clients or third parties of the potential implications of making payments less than the total amount owing;
- failing to pass on payments by a third party debtor to the client in a timely manner or to refer to the client any reasonable offer by the debtor to pay by instalments;
- pursuing debts which are statute barred.

We will look closely at your conduct if you make unjustified claims against a third party. An assertion that you were acting in the *"best interests"* of your client is not an answer to the making of an improper demand. You must not engage in business practices which are deceitful, oppressive or otherwise unfair or improper.

You should accurately and openly represent your authority/status in all communications, and convey in those communications the correct legal position with regard to debts and the debt recovery process.

What policies and procedures do I need to have in place?

Chapter 7 of the Code sets out the SRA's expectations of firms and individuals to ensure efficient running of a business.

When carrying on debt collection work (and other credit-related regulated activities) you must establish and implement clear, effective and appropriate policies and procedures to deal with for example:

- the fair treatment of clients or third parties whose accounts fall into arrears, and treating them with forbearance and due consideration;
- accurate and adequate data collection and recording;
- giving due consideration to any reasonable offer of repayment;
- not pressurising a client or third party debtor to pay more than they can reasonably afford or within an unreasonably short period of time;
- suspending the active pursuit of a debt for a reasonable period where the client or third party is developing a repayment plan;
- not refusing to negotiate with a client or third party who is developing a repayment plan;
- not refusing unreasonably to deal with a person acting on behalf of a third party debtor;
- not imposing unreasonable charges on clients or third parties for arrears or default; and
- the fair and appropriate treatment of clients and third parties, who you understand or reasonably suspect to be particularly vulnerable.

Can I outsource work to a debt recovery business?

If you outsource work to a debt recovery business, you must ensure that you achieve the Outcomes in Chapter 7 of the Code (Management of your business) and in particular, Outcomes 7.7 to 7.10.

You must ensure that **any** activities conducted in your name or on your behalf by a debt recovery business are not undertaken in a way which takes unfair advantage of others. For example, by making demands for payment from a debtor for sums (such as the costs of a letter of claim) which are not legally recoverable from the debtor or making aggressive or misleading demands for repayment.

You should also take steps to ensure that any debt recovery business you engage with is appropriately authorised where it is engaged in credit-related regulated activities.

Is my independence at risk?

When entering into an agreement with a debt recovery business, you must ensure that the terms and substance of the arrangement do not compromise your independence. A relationship with a debt recovery business which enables it to have control over the supervision of cases and/or the direction and management of a firm is likely to compromise the firm's independence.

Examples of situations where your independence may be at risk under an arrangement with a debt recovery business include:

- Financial dependency;
- Contractual conditions which cede control;
- Giving access to confidential information;
- A non-arm's length relationship which suggests that the firm is more akin to a subsidiary rather than an independent law firm; and
- Fee sharing arrangements beyond that allowed in Chapter 9 of the Code.

Can I share my fees and make referrals to a third party?

If you enter into an arrangement for a debt recovery business to refer clients to your firm, you must achieve the Outcomes in Chapter 9 of the Code. The arrangement must not compromise your independence and professional judgment, for example, by relinquishing control of the work to the debt recovery business.

You should not enter into an arrangement which is clearly not in the best interests of your clients or which compromises your ability to act in their best interests. An example of this would be an arrangement which requires you to pay monies recovered from the debtor to the debt recovery business rather than to your client.

The creditor will be your client and you must ensure that you achieve the Outcomes in Chapter 1 of the Code (You and your client). For example, failing to confirm the client's instructions at the outset of the retainer, or relying on the instructions of the debt recovery business where the client has not directly authorised this, may put you at risk in respect of the Outcomes.

You should also ensure that you comply with Rule 4.1 of the Scope Rules which requires you to account to your client for any pecuniary reward or other advantage which you receive from a third party.

What should I do if a debtor lacks mental capacity?

You should consider whether it is appropriate to pursue the recovery of a debt from a debtor when you are aware, or have been notified, that the debtor does not or may not have the mental capacity to make relevant financial decisions about the management of their debt and/or to engage in the debt recovery process at the time.

In these circumstances, and having regard to the obligation set out in Outcome 11.1 of the Code, you should consider whether it is appropriate to allow the debtor or a person acting on their behalf a reasonable period of time to provide evidence as to the likely impact of any mental capacity limitation on the debtor's ability to engage with you.

Further help and guidance

Further guidance on the application of the SRA Principles and the Code can be obtained from our Ethics Helpline – telephone 0370 606 2577