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Consumer redress schemes: the case of CFO Lending Limited

KEY POINTS

- Since 2010 the Financial Services Authority (FSA) (now Financial Conduct Authority (FCA)) has had the ability to impose consumer redress schemes, requiring firms to review past business, determine whether they have caused customers loss as a result of breaches of their regulatory obligations and, if so, to pay compensation.
- The powers, when granted, were regarded by many as controversial, as they permitted the FSA to determine not only a firm's liability for past conduct but also the compensation to be paid. The schemes therefore allow the FCA to bypass the usual court processes.
- However, consumer redress schemes have proved to be an effective and efficient way of ensuring recompense for consumers who have lost out due to a firms' poor behaviour.
- The Consumer Rights Act 2015 introduced US-Style "opt out" class actions for competition infringements known as "collective proceedings". The government has previously proposed the use of collective proceedings in financial regulation cases. It will be interesting to see whether the CRA 2015 will pave the way for collective proceedings in financial regulation cases.

In this article, George Mallet considers the benefits of consumer redress schemes in light of the redress recently provided to customers of CFO Lending Limited.

INTRODUCTION

The FCA has the power to compel firms to initiate and administer "consumer redress schemes" to compensate consumers who have suffered loss as a result of the firms' systemic inability to comply with its regulatory obligations. The concept is relatively simple. It involves three steps: if the FCA suspects that a firm has breached its obligations it can require it to investigate; if investigations uncover breaches, the firms can be required to determine whether the failure has caused (or may cause) loss or damage to consumers; if so, the FCA can order the firm to make amends. Usually the firm will be required to distribute compensation to consumers (although other remedies are available). All other things being equal, the consumer should be presented with compensation without having to have instructed lawyers or even investigate the matters themselves.

HISTORY

Prior to 2010, the FSA was only permitted to impose redress schemes with legislative support: see s 14 of the Financial Services and Markets Act 2000 (FSMA). Consequently, the power was rarely used (if ever).

Since the Financial Services Act 2010 came into force in October 2010, the FSA – now FCA – has had unprecedented powers to initiate consumer redress schemes. The Act was the product of sentiment following the global financial crisis. At the time there were wholesale concerns that large financial institutions were able to take advantage of the consumer with only minimal risk of being held to account. In many cases, the concerns were well founded. Consumers who fell victim to financial ill conduct generally had little chance of obtaining justice. Whilst legal proceedings were possible, losses were generally small, meaning legal fees were rarely justified. Moreover, the delays, risks and effort involved in bringing County Court actions against large institutions meant few consumers bothered to seek justice. Finally, firms' breaches are rarely apparent to consumers, meaning that they are not well placed to hold the firm to account.

So it was against this backdrop that the Financial Bill 2010 was proposed. As enacted, the Financial Services Act 2010 furnished the FSA (now FCA) with the ability to hold errant firms to account, to determine the amount to be paid by way of compensation and to distribute the proceeds to those affected. At their advent consumer redress schemes were regarded as controversial, not least as firms' limited right to challenge the imposition of the schemes ostensibly gave an executive agency – the FCA – the power to act as "judge, jury and executioner". Some time on, and in a climate that increasingly favours the consumer, the schemes are general regarded as a success and are a useful weapon in the FCA's arsenal.

THE BASICS OF CONSUMER REDRESS SCHEMES

The FCA's power to initiate a consumer redress scheme is derived from s 404 and ss 404A to G of FSMA and the Consumer Redress Schemes Sourcebook (CONRED).

The statutory definition

A consumer redress scheme is defined as a set of rules under which a firm is required to take one or more of the following steps:

- investigate whether, on or after a specified date, the firm has failed to comply with particular requirements that are applicable to an activity it has been carrying on;
- determine whether the failure has caused (or may cause) loss or damage to consumers; and
- if the firm determines that the failure has caused (or may cause) loss or damage to consumers, the firm must:
  - determine what the redress should be in respect of the failure; and
  - make the redress to the consumers.

When can a consumer redress scheme be imposed on a firm?

Consumer redress schemes can secure redress for consumers of services provided by authorised persons in carrying on regulated activities (and in various other circumstances). Before initiating a consumer redress scheme, the FCA will undertake a formal public consultation, including a cost benefit analysis.

The FCA can "trigger" a consumer redress scheme where:

- it appears to the FCA that there may have been a widespread or regular failure by relevant firms to comply with requirements applicable to the carrying on by them of any activity;
- it appears to the FCA that, as a result, consumers have suffered (or may suffer) loss or damage in respect of which, if they brought legal proceedings, a remedy or relief would be available in the proceedings; and
- the FCA considers that it is desirable to make rules for the purpose of securing that redress is made to consumers in respect of the failure (having regard to the other ways in which consumers may obtain redress).

Those familiar with consumer law are advised to pay close attention to the definition of a "consumer" given by s 404E(1) of FSMA. For the purposes of a scheme, a consumer can be any person who has used, or may have contemplated using, any of the financial services listed in s 404E(2). The definition is not limited to retail customers, but incorporates other persons who have legal causes of action against firms. The definition includes, for example, beneficiaries of funds and pension schemes. That said, a consumer redress scheme can only be used to secure redress for consumers who have a legal cause of action.

What type of redress can be ordered?

Usually a consumer redress scheme will result in the firm being required to provide monetary compensation to the consumers that have suffered loss due to a firms' improper activities. The firm will also usually be obliged to administer the redress scheme itself. However, redress is not confined to monetary awards. The redress must be 'just' and can include interest. The scheme must operate within applicable limitation confines.

Challenging a consumer redress scheme

Consumer redress schemes have been criticised as they authorise the FCA to determine matters of both liability and quantum against a firm without having to step into a court. The right to challenge a scheme is contained in s 404D of FSMA. Any person (eg firms, consumers or their representatives) may apply to the Upper Tribunal for a review of any rules made. The matter will be heard by a high court judge (or higher) and he or she will apply the principles applicable to judicial review.

Case study: CFO Lending Limited

In September of this year, CFO Lending Limited (CFO) entered into an agreement with the FCA to provide over £34m of redress to nearly 100,000 customers for unfair practices. CFO operates in the High Cost Short Terms Credit (HCSTC) market (ie "payday loans"). It traded as Payday First, Flexible First, Money Resolve, Paycfo, Payday Advance and Payday Credit.

Investigations date back to August 2014, when the firm voluntarily agreed to stop chasing outstanding debts whilst a review was undertaken. At the time, the announcement hotly followed similar voluntary applications for the imposition of requirements by two other HCSTC providers – Wonga Group Limited and Ariste Holding Limited. CFO was required to investigate whether its debt collection practices and automatic customer balance calculations had caused loss to its customers.

Following the completion of investigations, it was determined that CFO's failings dated back to the launch of its lending platform in 2009, and include:

- Showing incorrect loan balance information, resulting in some customers repaying more money than they owed.
- The taking of payment without permission.
- Making excessive use of continuous payment authorities to collect outstanding balances from customers.
- Failing to treat customers in financial difficulties with due forbearance, including refusing reasonable repayment plans suggested by customers and their advisers.
- Sending threatening and misleading letters, texts and emails to customers.
- Routinely reporting inaccurate information about customers to credit reference agencies.
- Failing to assess the affordability of guarantor loans for customers.

The redress consists of £31.9m written-off customers' outstanding balances and £2.9m in cash payments to customers.

OVERLAP WITH GROUP ACTIONS AND COLLECTIVE PROCEEDINGS

Interestingly, the Bill that preceded the Financial Services Act 2010 had initially proposed the introduction of US-style class actions for financial services claims. The proposals envisaged consumers bringing "collective proceedings" against financial institutions to hold them accountable for breaches of financial services legislation. In the event, the collective proceedings element of the Bill was removed prior to assent. Collective proceedings were apparently excluded because of timings; Parliament wanted to be seen to be actively managing the financial industry and so needed to legislate quickly. Unfortunately, collective proceedings proved too complicated to legislate within the tight timeframes.

Schedule 8 of the Consumer Rights Act 2015 (CRA) introduced "collective proceedings", albeit only in the competition law context. They differ from UK group actions – such as the claims brought by shareholders of both Lloyds and RBS – as they are "opt out"; claimants are automatically included in the litigation, unless they choose to "opt-out". At present, they are only applicable to proceedings in the Competition Appeals Tribunal involving competition law infringements.

Biog box
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It will be interesting to see whether the CRA will have paved the way for collective proceedings to be used in financial services proceedings. In many respects, financial regulation breaches would be well suited to collective proceedings. Breaches tend to occur over an identifiable time period and affect a defined group of consumers. Because financial products are often sold electronically with uniform contracts it is usually relatively easy to identify those that have lost out as a result of a firm's misconduct. This should be contrasted against the same of, say, electronic goods, where "classes" of purchasers are not as easily identified.

CONCLUSION

The suspicion is that, given the general perceived success of consumer redress schemes, it would be perhaps surprising if collective proceedings were introduced. One of the most appealing aspects of consumer redress schemes is that they require the firm to do the legwork; they are therefore both easy and cheap to initiate, from both the regulator and consumer's perspective. It is suggested that the benefits inherent in sensibly priced justice will, for now, outweigh concerns that the schemes give the FCA unprecedented powers to determine liability and compensation without having to step foot inside a courtroom. ■

Further Reading:

- Consumer redress in the financial services sector [2010] 7 JIBFL 403.
- Dispute resolution of financial services cases in England: any place for class actions? [2012] 7 JIBFL 395.
- LexisNexis Financial Services blog: Wonga – what does it say about the use of FCA investigatory powers?