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1 Introduction

1 In its 2003 White Paper *Fair, clear and competitive – The consumer credit market in the 21st century*, the Government committed to creating a fair, clear and competitive consumer credit market in the United Kingdom. The Consumer Credit Act 2006 (the '2006 Act'), which received Royal Assent on 30 March 2006, marks one of the key stages in the Government's programme by laying the foundations for a new legislative framework. Specifically, it reforms the UK's consumer credit laws by amending and augmenting the Consumer Credit Act 1974.

2 The 2006 Act is based around three main changes:

- Enhancing consumer rights and redress by empowering consumers to challenge unfair lending and through more effective options for resolving disputes;
- Improving the regulation of consumer credit businesses by streamlining the licensing system, requiring minimum standards of information provision to consumers and through targeted action to drive out rogues; and
- Making regulation more appropriate for different types of transactions by extending protection to all consumer credit and by creating a more proportionate regime for business.

3 This report focuses on the post-contract information obligations within the 2006 Act which require lenders to provide specific information about credit accounts to their customers at required points in time. The changes are designed to provide consumers with information throughout the life of their credit agreements, including when default sums are applied to their accounts and when their accounts are in arrears or default. In this way, Ministers expect the 2006 Act to deliver important improvements to transparency in the consumer credit market and so offer consumers greater protection.

4 Compliance with these new requirements means that lenders will potentially need to adapt their information and other business systems to provide the new information to their customers. As such, it is inevitable that these changes will give rise to additional one-off (as well as recurring) costs for those businesses which are obliged to comply with the provisions of the 2006 Act.

5 Although the 2006 Act sets out the framework of the new requirements, much of its detail will be added by secondary legislation, or Statutory Instruments (SIs). One of the two proposed SIs, provisionally called the Consumer Credit (Information Requirements and Duration of Licences and Charges) Regulations 2007, addresses the post-contract information obligations. It defines the form and content of the various statements and notices that lenders will be required to provide to all consumers about their regulated agreements to keep them informed about the state of their account[1].

6 In developing the draft Regulations, DTI has endeavoured to strike the right balance between ensuring that consumers are given the information they need without imposing undue burden on lenders. In order to do this, the DTI undertook a programme of pre-consultation with representatives from industry and consumer groups. For example, this pre-engagement meant that early proposals around providing

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[1] The SI also includes regulations that set the maximum duration of limited licences and the period within which periodic fees for indefinite licences must be paid but these are out of scope of this study.

dynamic information along with the information required for statements, were reduced in response to industry feedback. This was followed by a formal consultation process between August 2006 and November 2006. In addition, as part of its consultation on the SIs, the DTI sought to provide as much detail as possible about the expected requirements. Hence, the consultation document contained full draft SIs.

7 Given the significant changes in the consumer credit market since the 1974 Act came into force, the DTI wishes to implement the 2006 Act as early as practically possible so that its intended benefit can be realised quickly. The DTI's proposed timetable for implementation of the 2006 Act, which was announced in May 2006 following informal consultation with stakeholders, envisaged that the post-contract information obligations will come into force in April 2008 (see Table 1).

Table 1: DTI's implementation timetable for the 2006 Act – current status

Date	Provision(s) expected to come into force
June 2006	• Disapplication of s.101 of the 1974 Act (s.63) • Miscellaneous/technical provisions (ss.65-69) • Enabling powers for SIs to be made later on, and other 'supporting' provisions
1 October 2006 (CCD)[2]	• Extension of period to respond to default notices (s.14 (1))
Late 2006	• Change to definition of an individual (s.1)
6 April 2007 (CCD)	• Abolition of automatic unenforceability (s.15) • Unfair relationships (ss.19-22) for new agreements (there will be a one-year transitional period (i.e. until April 2008) before the test applies to existing agreements) • Alternative dispute resolution provided by FOS (ss.59-61 and Schedule 2)
6 April 2008 (CCD)	• Removal of financial limit (s.2) • High net worth and business exemptions (ss.3-4) • Post-contract transparency (ss.6-14, 16-18) • Licensing regime and OFT powers (ss.23, 26-54, 62, 64) • Consumer Credit Appeals Tribunal (ss.55-58, Schedule 1)
1 October 2008 (CCD)	• New categories of business – debt administration and credit information services (ss.24-25)

8 In response to its consultation, the DTI received extensive and, in some cases, challenging feedback about both the content of the draft SI and the timetable for its implementation.

Terms of reference for this review

9 Given the feedback to the consultation and the strong representations from some parts of business, the Department decided that it needed to obtain a more detailed, independent understanding of the key issues. In particular, further evidence was needed on the time likely to be required and the costs which are expected to be incurred by lenders implementing the required changes, especially to their IT systems, having regard to the readiness and potential availability of external service providers. Furthermore, the DTI wished to understand how (if at all) the feasibility and costs of implementing the post-contract information requirements could vary depending on the time allowed for implementation. As such, the research was intended to inform the Government's implementation planning in respect of the post-contract information obligations. Given the interests of businesses in the implementation exercise, as both lenders and service providers, the DTI wished to obtain an independent but expert view of the key

[2] DTI generally introduces legislation on two dates in the year, 6 April and 1 October (known as Common Commencement Dates).

issues. DTI was particularly keen to understand the implications for some of the major financial services firms which have argued that they would find it very difficult and/or costly to implement the required changes in 12 months. At the same time, DTI was aware that other groups of affected businesses could also struggle with implementation but have failed to articulate their case as vociferously.

10 In summary, this study has focused on addressing three key questions:

- What would be the implications if the draft of the SI published in August 2006 came into force in April 2008 in terms of both the ability of lenders to meet the requirements and the associated costs?
- What would be the costs, benefits and risks of different (slower) implementation timescales, recognising the need to tie in with one of the DTI's Common Commencement Dates (in April or October of each year)?
- How, if at all, would this picture vary between different groups of business?

Approach for this review

11 Our approach to these three questions has involved a combination of desk-based research and in-depth interviews.

12 The first step in our approach was to review the existing analyses of the potential implications of the 2006 Act. This involved analysing and reviewing the existing Regulatory Impact Assessment prepared by the DTI, the consultation documents developed in relation to the draft SI and the consultation responses from both business and consumer groups.

13 The second, key step in our approach was a series of in-depth discussions and consultations with business. This included trade associations that represent businesses affected by the 2006 Act and also individual companies which will need either to comply with the 2006 Act or will be called upon to provide services to enable these businesses to comply.

14 In determining the nature of the firms that should be approached for this study, the agreed approach was informed by two main factors:

- Feedback from pre-consultation and consultation which suggested that larger lenders had a much higher degree of concern about the implementation timetable, largely due to the size and complexity of their IT systems and customer volumes; and
- Recognition that although many small firms have consumer credit licences, their share of the market is quite small.

15 In practice, we contacted representatives of businesses of all sizes. Yet, the evidence which we collected has come primarily from larger firms which together account for a very significant share of the consumer credit market. Lenders were willing to provide a great deal of information provided that their confidentiality could be protected. In total, we consulted 26 different organisations covering a mix of products and sub-sectors as well as suppliers:

- 8 trade associations;
- 15 lenders; and
- 3 suppliers.

Report structure

16 The remainder of our report is divided into three further sections:

- Section 2 describes the context for our work: it outlines the scope and requirements of the 2006 Act and the draft SI which is the focus of this study and provides an overview of the market context within which lending businesses need to respond;

- Section 3 analyses how lenders and suppliers are responding to the 2006 Act and the draft SI and also examines the detailed implications of the draft SI published in August 2006 and timetable, and certain options for altering the requirements; and

- Section 4 summarises the main conclusions which emerge from our research and analysis.

2 Context: Requirements of the Consumer Credit Act 2006

Introduction

17 This section sets out the key aspects of the context for our research and analysis. It is divided into three main parts:

- An explanation of the scope and structure of the 2006 Act focusing, in particular, on the products that are affected;
- A discussion and analysis of the specific requirements within the draft SI dealing with post-contract information, including the proposed timetable for implementation; and
- An overview of the scale and structure of that part of the consumer credit market which is potentially within the scope of the 2006 Act.

Scope of the Consumer Credit Act 2006

18 The provisions of the 2006 Act in relation to post-contract information apply to consumer credit and consumer hire agreements.

19 The consumer credit products which fall within the scope of the 2006 Act potentially include secured property loans, secured and unsecured lending for goods and services, overdrafts, running account credit and short-term cash loans. Based on our discussions with a number of lending businesses, however, there remain some important uncertainties as to the precise scope of the 2006 Act.

20 For example, there was a significant amount of uncertainty, disagreement and concern amongst lenders about whether buy-to-let mortgages would fall within the scope of the 2006 Act or not. Some lenders pointed to DIT assurances that the business exemption set out in Section 4 of the 2006 Act would take buy-to-let mortgages out of scope; but others took an opposite interpretation. Other lenders took the view that this was not a concern as buy-to-let mortgages would fall under the exemption of section 18 of the 1974 Act.

21 More specifically, we also noted a substantial amount of confusion amongst lenders as to whether or not life time events such as divorce would constitute a modifying agreement and thus bring the mortgage within scope of the 2006 Act. Similarly, lenders mentioned the possibility of dual regulation by the 2006 Act and MCOB or the Financial Services and Markets Act 2000.

22 Lenders also pointed to the discrimination between investors arising from what they regarded as the rather arbitrary distinction between an individual investor holding a single buy-to-let mortgage with a view to expanding further and 'business' which would fall outside the scope.

23 Similarly, a number of banks have questioned whether current accounts fall within the scope of the 2006 Act, that is, would overdrafts fall within scope of the obligations relating to running account credit agreements.

24 This uncertainty about the scope of the 2006 Act has a significant bearing on the timetable and costs associated with implementing the Act. We discuss the implications of this issue further in the next section.

Post-contract information obligations within the 2006 Act

25 Table 2 summarises the seven information post-contractual obligations created within the 2006 Act. For each of the obligations, the table shows:

- The section reference to the obligation within the 2006 Act;
- The nature of the obligation, including the situation in which the information is required and the type of product to which it applies;
- The key pieces of information that lenders are expected to provide to their customers; and
- The circumstances in which the need to fulfil the obligation is triggered.

Table 2: Summary of post-contract obligations within the 2006 Act

Section of the 2006 Act	Obligation	Information required	Trigger
Section 6	Periodic statements setting out specified information about the account for fixed sum credit accounts which last for one year or more	• Period of statement • Debtor's name and address • Creditor's name • A telephone number or numbers and postal address • Account identifiers • Amount of borrowing • Applicable interest rates • Start date of agreement • How much longer agreement has to run • Opening balance • Payments made • Amount becoming due • Closing balance • Estimated end of loan period • Right to settle early, termination rights • Complaints procedure	Regular
Section 7	Additional information in running account statements, specifically warnings about the implications of not making required repayments or of only making part payments	As for set out in Consumer Credit (Running Account etc) Regulations 1983 plus • Notification if a payment date has been missed • Impact of only making minimum payment • Allocation of payments	Regular
Section 9	Notices of sums in arrears for fixed-sum credit agreements, which	• Why the notice is being sent • Encouragement to discuss • Notice date	Contingent

Section of the 2006 Act	Obligation	Information required	Trigger
	will be required to be provided after a specific threshold of arrears has been reached and which will include specific information about the account and the implications of being in arrears for the consumer	• Agreement description for which the note is being sent • Contact details of creditor • Contact details of debtor • Details of missed payments • Further default sums and interest liable • When next notice is due • When payment must be made • Scope of arrears notice • OFT statement about arrears • Advice of right to apply for time order	
Section 10	Notices of sums in arrears for running account credit agreements, which will be required to be provided after a specific threshold of arrears has been reached and which will include specific information about the account and the implications of being in arrears for the consumer	• Why the notice is being sent • Encouragement to discuss • Notice date • Agreement description for which the note is being sent • Contact details of creditor • Contact details of debtor • Details of missed payments • Further default sums and interest liable • When next notice is due • When payment must be made • Scope of arrears notice • OFT statement about arrears • Advice of right to apply for time order	Contingent
Section 12	Default sum notices, which will be required when the consumer incurs a specified level of default sums	• Why the notice is being sent • Details of default sums • Interest on default sums	Contingent
Section 14	Additional information in default notices issued under s.87 of the 1974 Act, which are required before the lender can enforce the agreement	• Reminder to debtor that they have the right to end the agreement themselves • Reminder to debtor that creditor may apply interest after a judgement • OFT sheet should be included	Contingent
Section 17	Notices in relation to post-judgment interest, to provide consumers with judgments against them in respect of which interest is sought by the	First judgement letter • Why interest is being charged • The date of the notice • Description of the agreement and the case number of the judgment • Creditor contact details • Debtor contact details	Contingent

Section of the 2006 Act	Obligation	Information required	Trigger
	lender, to receive information about that	• Rate at which post-judgment interest is or will be charged • Amount on which post-judgment interest is or will be charged • Advice on who to contact if having difficulty Subsequent letters • Additional charges since first letter • Dates on which additional charges have been applied Creditor must advise debtor that they can apply interest after a judgement immediately and then at intervals of not more than 6 months	

Implementation principles

26 As we noted in the introduction, the DTI's overarching aim in developing its implementation plans for the 2006 Act has been to realise its intended consumer benefits as early as possible, reflecting the changes in consumer credit market since the 1974 Act.

27 In developing its detailed proposals for implementation, and specifically in preparing the draft SI under the 2006 Act, the DTI has sought to follow the Better Regulation Task Force's *Principles of Good Regulation*[3] (revised by the Better Regulation Commission). This has meant that the DTI has sought to ensure that the post-contract obligations are:

- Proportionate, in the sense that the requirements on business are in proportion to the consumer benefits being sought: the DTI believes that, while consumers should receive information about their credit agreements that meets the required standard, businesses should have the flexibility to present that information in a way that is practical and as cost-effective as possible to them;
- Accountable: to ensure that the requirements respond to consumer need as well as business practice, and that they are flexible and can change according to changing circumstances;
- Consistent: to ensure that the requirements apply consistently to all consumer credit businesses and provide consumers with the same degree of protection, and that the regulation is consistent with other Government initiatives;
- Transparent: to ensure that those affected are consulted before regulation is finalised, and that businesses can understand and comply with the new requirements; and
- Targeted: to ensure that the requirements address those areas where regulation is needed, without imposing unnecessary burdens. In order that the provisions may apply across this wide range of business models and sectors, the DTI has tried to keep the level of prescription and detail to a minimum.

Timetable

28 The DTI has worked on the basis that it would like the new requirements to come into force in April 2008, 12 months after the final SI has been laid before Parliament. This reflects six considerations:

- The DTI wishes to implement the proposals at the first opportunity possible;
- All provisions affecting industry must be commenced on a DTI Common Commencement Date (CCD) of either 6 April or 1 October recognising that it would not be possible to commence everything

[3] See http://www.brc.gov.uk/publications/principlesentry.asp for more details.

immediately and legal constraints within the 2006 Act mean that some sections must be commenced simultaneously or in a certain order;

- The DTI, whilst recognising that lending businesses might wish to wait for the final provisions of the SI before starting work on implementing the required changes, believes that by having provided detailed drafts of requirements and by indicating that it expects these to be subject to only relatively minor modification as a result of the consultation process will enable business to have the knowledge and confidence in the likely shape and detail of the new requirements to start its preparations;

- Business has been involved closely in the preparation of the draft SI and this has meant that some of the more complicated ideas involving the need for 'dynamic' information (i.e. information specific to the individual agreement) have been removed and others have been modified to require only a generic statement on the grounds that the additional cost to business was not justified by the small additional benefit to consumers;

- Recent regulations of a similar nature have been successfully implemented by lenders in 12 months, including the requirements brought in by the Consumer Credit Act Agreements Regulations and Early Settlement Regulations, and the FSA's implementation of mortgage regulation in 2004-2005; and

- Specific provisions of the 2006 Act permit longer periods before compliance is mandatory, for example in relation to periodic statements for fixed-sum credit agreements, where the first statement is required within one year of the making of an agreement or, for agreements made before commencement of the provisions, one year from the date of commencement.

Overview of consumer credit market

29 The consumer credit market is substantial and diverse.

30 A consumer credit business is defined as by the 1974 Act as "any business so far as it comprises or relates to the provision of credit under regulated consumer credit agreements". A consumer hire business is defined as "any business so far as it comprises or relates to the bailment or (in Scotland) the hiring of goods under regulated consumer hire agreements".

31 The consumer credit industry includes banks, home credit companies, mail order companies, those providing credit for goods, credit cards, store cards, cheque cashers, credit brokers and many more businesses, and who have current outstanding loans to consumers valued at around £1 trillion, of which more than 80% is mortgage lending (now regulated by FSA). It is characterised by strong competition – the UK consumer credit market is often cited as the most developed in Europe – and no single firm has more than a 10% share of the market. Table 3 sets out information on the structure of this market.

Table 3 – Information on the size and nature of the UK consumer credit market[4]

Product	Number of providers	Number of customers/accounts	Value of lending (£ bn)
Credit cards	50	32 million customers, 57 million accounts	£65 billion
Store cards	50	20 million accounts	£5 billion
Loans and overdrafts	80 retail banks, 20 building societies	15 million accounts	£147 billion
Instalment credit	-	-	£4 billoion
Secured mortgages	160	11.7 million mortgages of which 0.85 million buy-to-let	£1,200 billion of which £95 billion buy-to-let

[4] Information provided by the British Bankers Association.

3 Potential impact of the Consumer Credit Act 2006

Introduction

32 This section explores the potential impact of changes introduced by the 2006 Act from the perspective of lenders and the likely effects on their customers.

33 The first part focuses on the following series of key questions:

- How do lenders typically adapt their IT and business systems to legislative change?
- What are the key characteristics of the IT systems used by lenders?
- What are the implications of system complexity for implementing the 2006 Act?
- How do the changes required by the 2006 Act compare with other recent regulatory requirements?
- What is the current status of lenders' implementation projects?
- What are the potential effects of the 2006 Act changes on customers?

34 The second part examines how each of the seven post-contractual information obligations will impact on lenders. Our analysis sets out the difficulties and issues associated with implementation and identifies a number of possible mitigating measures.

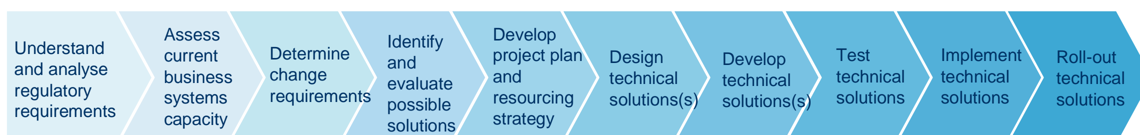
35 Our analysis is driven by data and information that we have gathered from the key players in the UK consumer credit market. Lenders have requested confidentiality, but we have attempted as far as possible to highlight some of the key points that they have raised.

How do lenders typically adapt their IT and business systems to legislative change?

The process for implementing systems change

36 Based on our experience in helping financial institutions manage legislative change, it is possible to set out a typical process that is used when implementing system change. There are a number of generic steps that are required to deliver business and technology systems change, starting from requirements analysis through design, and then developing and implementing an appropriate solution. A typical sequence of activities is set out in Figure 1 below.

Figure 1 – Typical sequence of activities for systems change



37 This typical sequence can be decomposed to show more detailed actions. Table 4 shows the activities a lender would be expected to undertake as part of each of the steps to define and implement the project requirements.

Table 4 – Core project processes for adopting business and technology change

Step	Activities
Understand and analyse the regulatory requirements	• Understand statutory changes required (e.g. default fees are charged at 0% interest for 28 days, then simple interest is charged) • Understand nature of functional changes required for each post-contract information obligations • Understand products within scope for each area of the change • Understand reporting change requirements for each post-contract information obligation
Assess current business systems capacity	• Holistic assessment – this will map the regulatory requirements onto the existing business systems. It will typically consider internal and external systems, business and technical system, technology and personnel
Determine change requirements	• Define and agree process changes required • Define and agree roles within each process • Define and agree existing and/or additional data required within each process • Define and agree application support required within each process • Define and agree gaps and opportunities for application enhancement required to meet changes • Complete requirements definition – functional, non-functional, business processes, interfaces, user profiles, security, audit, operational/ service levels, business data, business continuity
Identify and evaluate possible solutions	• Agree solution alternatives • Define costs and benefits • Define prototyping approach • Define and agree solution sourcing options - RFI/ITT, package selection criteria and evaluation, vendor negotiation • Define test strategy • Define deployment /data migration strategy
Develop project plan and resourcing strategy	• Define implementation project road map – methods, tools, techniques • Define issues, assumptions, constraints, risks and project management approach • Define and agree resourcing availability, acquisition and plans to expand to meet project requirement (including impact on business as usual programmes)
Design technical solution(s)	• Define impact on target systems architecture • Logical design - application architecture, process/event models, logical data model, system processes, user and system interfaces • Technical impact analysis - IT platforms, networks, security systems, system and data architecture, systems technology, IT operations • Organisational impact analysis - business processes, organisation structure and roles, change management • Review/refine solution - costs and benefits, schedules, test strategy, deployment strategy

Step	Activities
Develop technical solution(s)	• Create development environment and processes • Physical design - functional specifications, user interfaces, component boundaries, system interfaces, migration routines, databases, technology platforms • Software development - program specifications, program code • Unit test - component test, test cases/scripts/data, operations and user procedures, training material (end use and technical)
Test technical solution(s)	• Create testing environments • Perform unit tests • Perform system tests • Perform integration tests • Perform security tests • Perform user acceptance tests • Perform stress testing • Perform data migration tests • Perform deployment tests • Perform disaster recovery tests
Implement technical solution(s)	• Review of production environments – hardware and software, networks, interfaces, operational processes, disaster recovery procedures, documentation, technical training • Define and agree deployment plans - physical environment, procedures, documentation, end-user training, security/access
Roll-out technical solution(s)	• 'Go live' – define cut-over schedule, back-out procedures, data migration, end-user roll-out • Define and agree immediate post deployment environment - fault fixing, enhancements, warranties, tracking any agreed Service Level Agreements, project reviews, improvements implementation

38 Testing forms a significant workstream within any technology change programme, particularly in banks which tend to have older systems that are core to their business operation. Table 5 below provides more details on the typical stages of a testing process that a lender would need to address before releasing any changed code into live operational systems.

Table 5 – Testing procedures used in business and technology system change

Testing process	Activities
Create testing environments	Involves setting up a virtual environment replicating the operational systems to support all subsequent testing activities without impacting the live environment
Perform unit tests	Every change made to functionality within a system is tested in its own right
Perform system tests	Testing all systems when functions have changed e.g. testing all credit card systems for interest calculations
Perform integration test	Testing that changed systems work properly with other systems e.g. credit card systems and statement issuing systems
Perform security tests	Testing that the required level of security can be maintained in the changed systems
Perform user acceptance tests	This would typically involve testing systems from the end user's point of view e.g. if changes alter the systems used by call centre staff, then testing will be required to ensure that this will not negatively impact the customer experience

Testing process	Activities
Perform stress testing	Ensures that the systems can scale up to cope with typical volumes e.g. a lender might test issuing 100,000 statements in a day – the new system must be able to scale to meet typical demand levels
Perform data migration tests	When the changed systems are operational, data from the old system such as customer account details will need to be migrated onto the new version – this process tests how that will work
Perform deployment tests	Involves production acceptance testing including running the changed systems on the production environment hardware to check that the processes happen appropriately in a suitable timeframe e.g. a lender might check if the processing can happen in the usual batch timeframe.
Perform disaster recovery tests	Lenders will have well established disaster recovery processes and systems; this form of testing ensures that the changed systems will not impact the disaster recovery processes

39 Each of these steps typically needs to be reiterated in several test cycles and this is a major driver of the time needed for testing. Moreover, every round of tests may reveal a number of defects which must be analysed to establish whether there are any faults and, if so, the reasons for them (for example, environment, hardware or coding problems). These issues then need to be resolved, for instance, through further development work and a subsequent code release or changes to the testing environment. Moreover, because of the possibility of errors occurring downstream, it is important that at every round of testing, all scenarios are tested. This ensures that the functionality that was previously in place is not affected by the subsequent release (caused by the original faults).

40 Another source of complexity is that testing environments use a different chronology to 'real time'. That is, a 'logical day' within a particular test scenario does not typically correspond to a real time day. For example, in some test scenarios such as a month end, the activities to be covered in one 'logical day' could actually take a week in real time.

Alternative implementation approach

41 The development approach documented above is a standard development approach known as the 'waterfall' approach (because each phase is done in sequence). Sometimes, to deliver a solution more quickly, businesses use a compressed development approach known as Rapid Application Development (RAD), an 'iterative' development approach designed to speed up delivery. The 'iterative' approach is also known as the '80:20' approach because it involves the business and IT teams working together very closely at an early stage to deliver rapidly the 80% of functionality that matters most.

Figure 2 – Process map for Rapid Application Development (RAD)

42 An 'iterative' approach may be suitable if business requirements are either not known or change rapidly - the process assumes that there will be iterations around the requirements phase. Business users are involved from the start so that they are more likely to get what they need and buy into its use.

What are the key characteristics of the IT systems used by lenders?

43 Our interviews revealed that the majority of the large financial services organisations active in the consumer credit market have a large and complex range of systems which may be impacted by legislative change. They typically have multiple systems for each product class and different stages in the product lifecycle. For example, a credit card customer in default will be moved to different systems to deal with the debt collection. The majority of the lenders stated that their systems landscape supporting these products has developed over a long period of time (in most cases going back to the 1960s).

Moreover, the number of takeovers and mergers in the sector since the 1960s has led to multiple legacy systems being bolted together (rather than truly integrated). Inevitably, in such a long period of production use, these systems have become large, outdated, complex and unwieldy to maintain and update. For example, a typical core banking systems landscape might look as follows (see Figure 3 overleaf).

44 The functions of the various systems can be explained as follows:

- **Channels** - Interfaces with the end customers of banks, they will consist of a mixture of electronic channels (internet, phone, mobile), call centre and physical (branch, post);
- **Channel Management** - Physical management and integration of the channels, allowing for personalisation of content;
- **Customer Interaction Layer** - Maintains a total view of the relationship and contact history of every customer and ties together all other activities that are required;
- **Operational Customer Management** - Controls the operational contacts between the organisation and the customer;
- **Customer Management and Analytics** - Defines the way in which each customer should be treated by each point of contact;
- **Business Integration Layer** - Provides the 'glue' to provide 'end-to-end' processing and also a range of value-added services;
- **Product engines** - Provide the core capability to service products and retain the detailed account postings and records;
- **Partner Management Systems** - Manage the relationship of the organisation with each external partner;
- **Enterprise Systems** - Normal systems required to manage the business of the organisation e.g. Finance, HR; and
- **Mailing and Payment Gateways** - Normal systems required to generate payments such as SWIFT, BACS and CHAPS.

45 In practice, for the reasons noted, the layers are not always inter-connected in a clean, structured manner. So, for example, many of the developments in recent years have consisted of new 'front end' developments bolted onto old 'back ends' by a series of software adapters (known as middleware). Middleware allows functionality to be added from either the customer side or for a regulatory change such as the 2006 Act using new, flexible front end systems without the time, cost and risk of having to change the old back end systems. In principle, this should make it easier and less risky to implement change (but over time, adds extra complexity).

Figure 3 – Model of typical core banking systems landscape

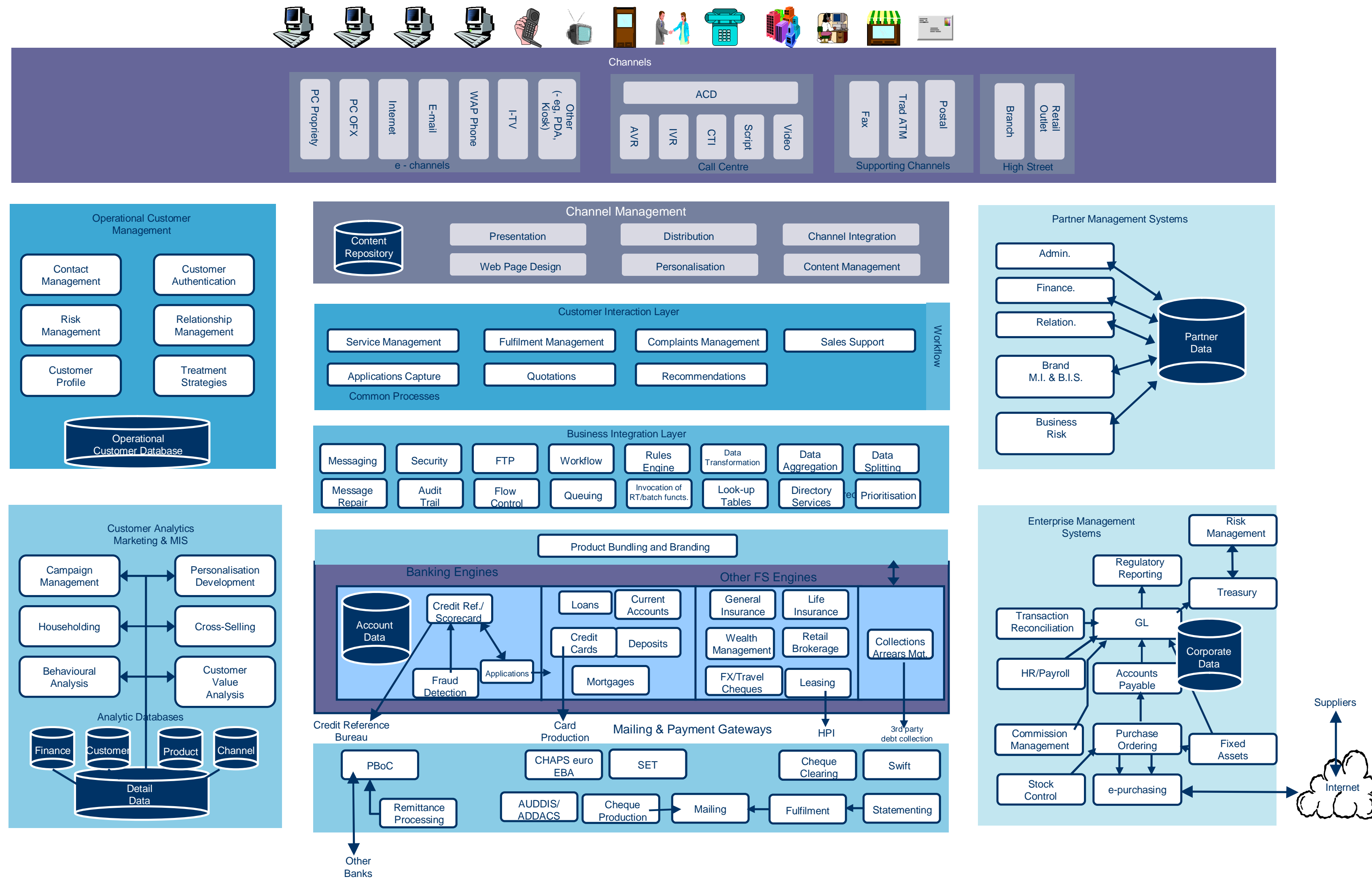
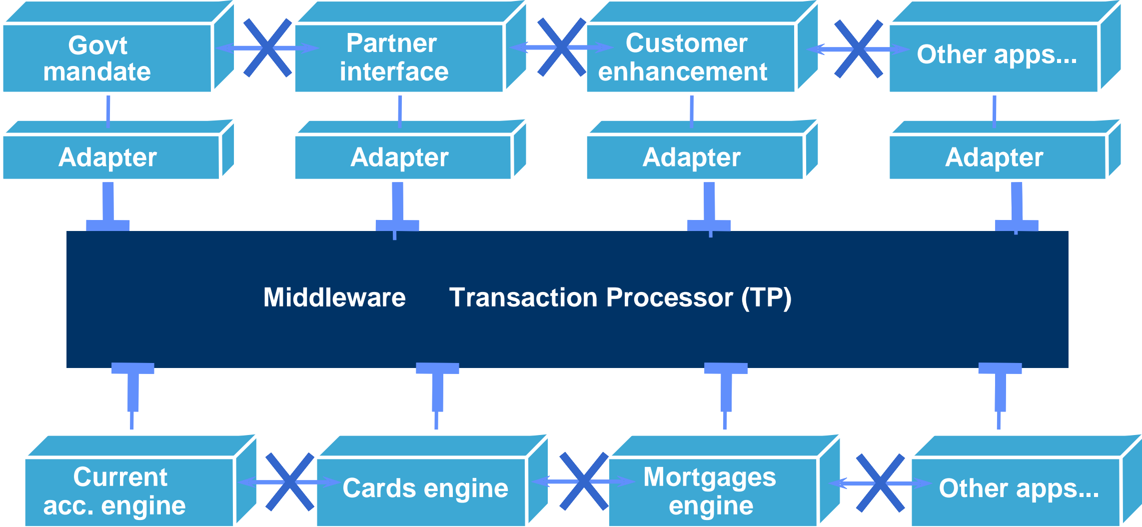


Figure 4 – Model of how middleware can be used to implement change projects



What are the implications of system complexity for implementing the 2006 Act?

The general picture

46 During our discussions, the majority of the lenders we interviewed stressed that one of the major challenges (and risks) arising from the 2006 Act was that a wide range of systems required change. This reflects the large number of products which are in scope and also the fact that the requirements apply across the lifecycle. In some cases, the lenders indicated that the number of affected systems ranged from 25 to well over 100.

47 In addition to the number of affected systems, it is important to note that many of the systems affected are central to the lender's business operation – for example, current accounts for millions of customers. Taken together, these two factors have significant implications for the testing processes required. All the lenders that contributed to the study were particularly concerned with the extensive testing requirements associated with implementing the 2006 Act. As so many products were in scope, and the requirements span the whole lifecycle of the agreement, this means that many systems will be impacted. As a result, there are a very large number of individual systems to test. Furthermore, the degree of interconnectedness means significant regression testing is also required (i.e. testing that changed systems work properly with other linked systems, for example credit card systems and statement issuing systems).

48 In addition, the requirements of the 2006 Act require extensive testing around certain key activities. In particular, lenders have highlighted the threshold for triggering a Notice of Sums in Arrears. They were concerned about the large number of scenarios that would have to be tested:

- Two missed payments in consecutive months;
- Two missed payments that do not fall in consecutive months (where other full or part payments may be made); or
- Other combinations of part payments over a number of months to the point where the sum in arrears equals two regular payments.

49 Furthermore, the annual statement of account will mean that some lenders will wish to test more than a year's worth of account data to ensure that their systems will support accurate statementing for all the relevant accounts. Some lenders told us that they would like to run several annual testing scenarios - working on the basis of one week's real time equating to one month of logical time. This would imply that testing these scenarios alone would take a minimum of 12 weeks.

Buy-to-let mortgage providers

50 There was a clear differentiation between providers of buy-to-let mortgages and those offering other products. The degree of readiness for mortgages amongst lenders is lower than for any other product. This is partially due to the fact that up until autumn last year DTI signalled that buy-to-let was out of scope, thus lenders did not embark on analysis of the requirements. However, the system implications are even more severe compared to other products under consideration in this report because up until now mortgages are not regulated by the 2006 Act and there is thus no rudimentary capability to deal with the 2006 Act built within any system to fall back onto.

How do the changes required by the 2006 Act compare with other recent regulatory requirements?

51 We asked the lenders to compare the scope and time required to implement the potential changes arising from the 2006 Act with that of other large regulatory programmes that they had delivered recently. The majority of the lenders we interviewed stated that programmes (such as the Mortgage Conduct of Business changes) took between 18 months to 3 years to deliver. They also stated that the 2006 Act changes are considerably more complex than other recent regulation change programmes. Table 6 compares a number of recent legislative changes which affected lenders.

Table 6 – Scope comparison between Mortgage Regulation, Consumer Credit Regulations 2004 and the 2006 Act

	Mortgage Conduct of Business (MCOB)	Consumer Credit (Early Settlement) Regulations 2004	Consumer Credit (Disclosure of Information) Regulation 2004	Consumer Credit Act 2006
Product scope	One product	Many products	Many products	Many products
Customer scope	Mainly new accounts	All accounts including back book; but long transitional period	Mainly new accounts	All accounts including back book
Lifecycle scope	Mainly new accounts	When the consumer wishes to settle the debt	Mainly new accounts	All accounts throughout the lifecycle
Change scope	Revision of existing communications	Some data calculations, revision of existing communication	Revision of existing communications	Extensive new data calculation (e.g. zero interest, simple interest), new activities and revised communication

52 In summary, lenders felt that implementing the 2006 Act was more challenging because:

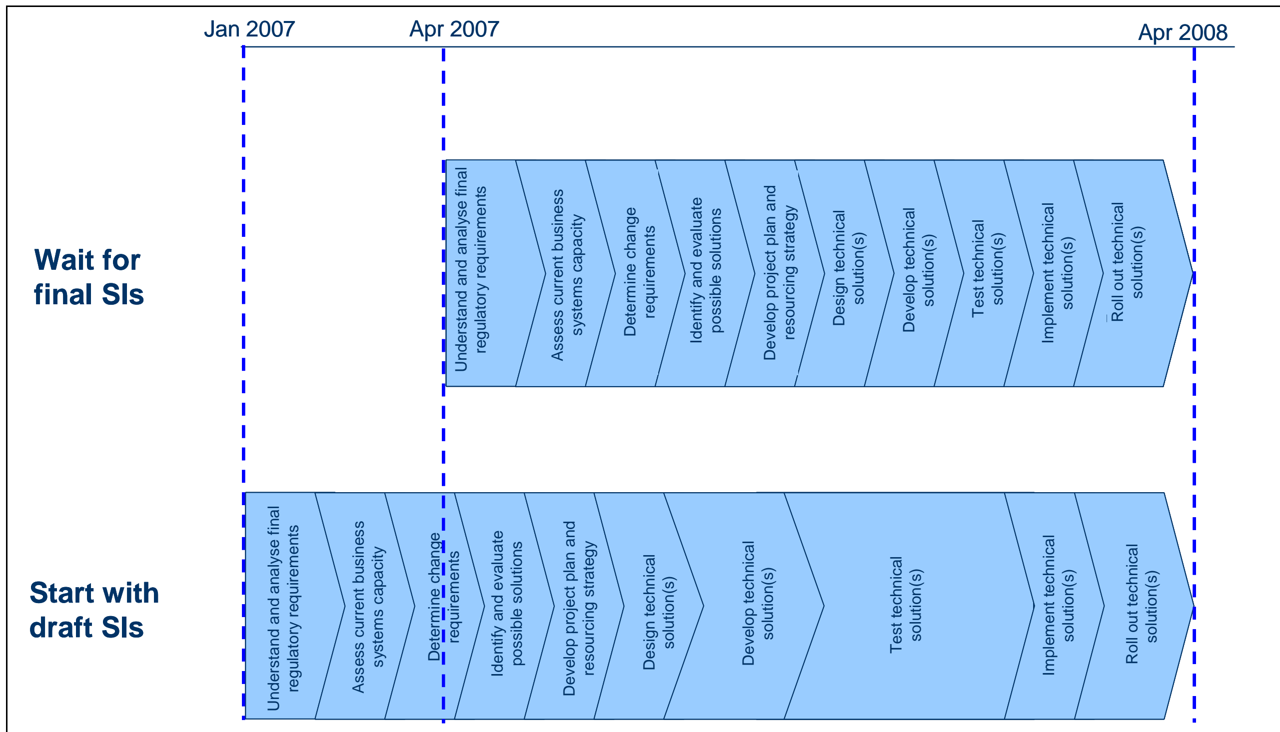
- It affects multiple products:
- It applies to all accounts including the backbook;
- It applies throughout the lifecycle of the credit agreement; and
- It requires extensive new data calculation.

What is the current status of lenders' 2006 Act implementation projects?

The evidence we gathered suggested that lenders had adopted one of two distinct approaches for delivering the implementation (see

53 Figure 5).

Figure 5 – Lenders' alternative scheduling approaches to the 2006 Act



Wait for the final SI

54 Those lenders that have decided to wait for the final SI took the view that the lack of clarity surrounding the draft SI made the risk of starting before they are finalised in April too high. They have, therefore, decided to wait until April to start requirements analysis. In some cases, they feel that the draft SI makes it too difficult to define the technical solution required. In addition, they are concerned about taking a different interpretation to other lenders. The main advantage of this approach is that requirements will be clearer in April thus optimising the time taken to complete this activity. The main disadvantage is that it leaves a bare minimum of time (12 months) to deliver a programme of this scope and complexity and that additional resources will need to be diverted from other projects.

55 Lenders were most concerned about completing the extensive testing needed in the time allowed. This particularly applied to the information obligations where actions over multiple periods will affect communications – for example the annual statement for fixed term credit agreements. Also, given the number of systems involved, extensive regression testing will be needed to make sure all the various elements of the systems work appropriately after the changes have been made. Lenders felt that given the timetable for implementation was very tight, it was possible that the testing period would be reduced (as the main source of contingency time). This may have fundamental implications in terms of compliance and the customer experience. The other area at risk is training, which again is likely to impact the customer experience.

56 To summarise, this approach lowers the requirement accuracy risk but increases the delivery risk. The majority of lenders we spoke to have adopted this approach.

Start with the draft SIs

57 The lenders who started the project based on the draft SIs took the view that there was an unacceptably high risk that the programme could not be delivered in April 2008 if requirement gathering starts in April 2007 with the final Regulations. Furthermore, as some of the core requirements are set out in the Act itself (such as the requirement to charge simple interest on default fees), some lenders felt it was possible to start work with some degree of certainty.

58 In order to adopt this approach, lenders have been required to make assumptions about the nature of the

final Regulations. For instance, the requirements will not change or that they would change in certain areas in a certain way (for example, statements for fixed term credit agreements will be able to show debits and credits on the account, rather than payments falling due and payments made). Using this approach means that an additional requirement review will be needed in April 2007 when the final Regulations are laid before Parliament. Depending on the extent of the change, it may be necessary to review the solution as well. This strategy, therefore, implies that the lender accepts a risk that extra change costs may be required.

59 The benefits of this approach are that lenders will have more than 12 months to implement the changes – this should allow more scope for prolonged testing. For example, one lender we spoke to started work on the 2006 Act changes in 2005. The drawbacks of this approach are that major rework may be required if the Regulations change in April 2007, and if the changes are extensive, then a significant investment may be lost. For example, one lender we spoke to is already 25% through the spend associated with the whole programme – this could be a substantial sunk cost if the final SI changes a great deal from the draft Regulations. So, for instance, a lender could assume that all the back book will be covered by the 2006 Act and started work on that basis. Then, if transitional provisions mean that the back book is out of scope, then any work undertaken is unnecessary and resources could have been used for other activities.

60 In short, this approach raises the requirement accuracy risk but decreases the delivery risk (as long as the assumptions are largely right). A small minority of lenders we spoke to have adopted this approach.

Choice of approach

61 Whilst most lenders have claimed that there is insufficient clarity to start implementing the changes required by the 2006 Act, it is important to note that this is not universally true. For instance, a minority of lenders have felt there is sufficient clarity to move forward on at least some business/ technical requirements. For example, the requirements set out on the face of the Act such as the requirement to charge simple interest on default sums. Most lenders have *chosen* to wait until the final SIs are published – but it is clear this is not the only feasible approach to implementation.

62 We could not identify one specific rationale as to why lenders had aligned themselves with a particular approach. It is most likely to be a combination of their preferred approach to programme delivery, their appetite for risk, their development approaches, the closeness of the relationship between their business and IT areas, and their level of engagement with DTI.

63 Nevertheless, regardless of whether lenders *could* have started work before the final SI was laid, it is very clear that the majority have chosen not to.

64 We also asked lenders what scope they anticipated for employing Rapid Application Development (RAD) in order to achieve quicker implementation. Lenders were emphatic that the scope for using RAD was limited for a number of reasons.

65 Some felt it was not a suitable approach because:

- Users need to be involved in the whole of the development process so business and technology teams need to be co-located and this was not often the case; and

- The approach relies heavily on prototyping so projects where the functionality is not readily visible at the user interface may not be suitable.

66 Furthermore, the specific characteristics of the changes required by the 2006 Act make a RAD approach more difficult:

- There are significant consequences associated with incomplete implementation – for example, accounts become unenforceable and interest cannot be charged;

- Large product scope – because the 2006 Act changes involve multiple products, use of this approach would require a large number of business people to be involved, which may not be possible. The lack of clarity in product scope in some areas may cause incorrect decisions to be made about functional

requirements; and

- Large lifecycle span – because the 2006 Act changes cover so many areas of the product lifecycle, one again many business people would need to be involved.

Resourcing and costs

67 The DTI's draft Regulatory Impact Assessment for the 2006 Act suggested that large lenders would each face implementation costs of between £10,000 and £50,000 and that the total cost across the economy would be between £20m and £90m. This assessment was based on the best available information at the time and the estimates were not challenged by lenders or other groups.

68 As part of this study, we asked lenders to estimate the number of resource days that they expected to need to implement the 2006 Act changes. Most lenders supplied high level estimates, and stressed that these were very early estimates only and reflected predominantly IT resources. Thus, the current cost estimates did *not* typically include business analysis and training costs – several banks told us they would expect this to cost as much as the IT estimates. Lenders did not provide more detailed estimates either because many had not prepared comprehensive cost estimates or because they were not willing to share this highly sensitive information.

69 The estimated number of resource days to comply with the 2006 Act changes ranged widely. Of the lenders we spoke to, the lowest number of days was 2,300 and the highest was 181,000. This equates to an estimated cost of between £1.1m to in excess of £40m for IT implementation. Excluding the outliers, the median number of days was 12,000 and the mean was 17,340 (and the associated IT implementation cost of £6m and £8.7m[5] respectively).

70 There was some evidence of a positive relationship between the amount of detailed analysis the lender had undertaken and their estimated costs. That is, those lenders who had analysed the implications in more detail tended to have higher cost estimates. Therefore, bearing in mind that most of the lenders interviewed have not yet completed their detailed technical and business analysis, it is more than possible that the cost estimates could rise significantly.

71 For example, the lenders indicated that many of their staff and associated resources would be impacted by the changes, such as branch staff, call centre operators, arrears specialists, debt collection agency staff as well as relationship managers and IT staff. The number of FTEs impacted ranged (depending on the product area) from several hundred to well over 18,000 (which included all branch and call centre staff). Given the number of staff affected, the lenders will also need to complete extensive training, change management and communication. For example, call centre staff will need to provide advice to customers on the new annual fixed term statements.

72 For completeness, we estimated the potential costs associated with training and communications. If we assume, as lenders have suggested, that business change costs will be the same as IT implementation costs, then we can expect the median cost for complete implementation to be £12m and the average total implementation cost to be £17.3m.

73 We therefore suggest that the overall costs to business of implementing the transparency requirements may be in the order of £500m.

74 We also collected evidence about the cost of implementing the 2006 Act for buy-to-let mortgages. As mentioned previously, this product area is probably the least well prepared. Lenders that could break down the implementation costs by product told us they faced projects costs of between £1m and £2.8m for buy-to-let. Again, they highlighted that this generally covered IT costs. As with other lenders, the associated business costs may double the total final cost of implementation. In addition, the Council of Mortgage Lenders claimed that the total cost of implementation for the entire mortgage business was around £100m.

75 On a separate note, lenders will face opportunity costs caused by implementing the 2006 Act. The

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[5] These figures are based on a small data sample so are not statistically significant.

lenders who highlighted this issue seemed more concerned with the availability of staff resources rather than the cash cost implications. So, projects will compete for staff – some of the work is mandatory (e.g. regulation), other programmes are discretionary. For example, other competing regulatory and legal projects which are currently underway or expected to start shortly, such as:

- Basel 2;
- Markets in Financial Instruments Directive (MIFID);
- Changes following from the EU Consumer Credit Directive; and
- Expected changes from the OFT's review of current account charges.

76 In terms of discretionary projects, these can be related to business restructuring, technology upgrades or customer-facing systems improvements. For example:

- A number of the lenders we spoke to are in the middle of merger integrations;
- Another was in the process of moving its business customers from a legacy platform system to a more modern solution; and
- All the lenders had other customer focused projects that would, for example, support more products or better services.

Reliance on external suppliers

77 We asked lenders who would be responsible for making the changes required in implementation, and to highlight any risks or issues associated with suppliers. We also interviewed a number of large and small IT suppliers about their understanding of the 2006 Act changes, their state of involvement and readiness and their ability to deliver solutions for their clients, the lenders.

78 The supplier issues raised by lenders differed according to the product:

- For products where in-house bespoke systems have been in place for a long period of time (e.g. current accounts), lenders tend to support these systems themselves because they are highly customised. There may be associated opportunity costs with using internal resources – for example, other IT projects cannot be supported – but there is not generally an issue with availability. However, if lenders need to source extra staff to support these legacy systems, that would be very difficult. For example, several lenders told us there are only a handful of programmers that can code in some of the more outdated programming languages that are used by these legacy systems.
- For products where packaged systems had been purchased, external resources tend to be supplied from a large onshore and offshore pool of resources who have been trained in that system. Many of the newer products have been highly parameterised and, according to the vendors, changes such as the 2006 Act that need to be made for multiple lenders can be done once and then individualised through parameter settings.
- For some products, specifically credit cards, many lenders use outsourced service providers, that rely on the service provider's own systems. These suppliers will adopt similar system change plans to the lenders, as explored earlier in the section. However, different factors affect the complexity of these system changes. On the one hand, the service providers deal with a limited number of products, so making the change process easier. On the other hand, the degree of complexity is higher because requirements, solutions and testing must be signed off by all the customers. Some of the smaller lenders had some concerns about what would happen if they had a different interpretation of the Regulations from other larger customers. Furthermore, the smaller lenders noted that there was a risk that the service providers would prioritise their largest customers when it came to testing and rollout. We understand that at least one of the service providers has previously failed to meet implementation deadlines for a regulatory change project. The service providers we interviewed were confident that their businesses were prepared for implementation.

79 Until the 2006 Act requirements are finalised, it cannot be said for certain that external suppliers will be able to satisfy the requirements of their clients. Suppliers indicated to us that they feel they are actively managing the implementation risks, but independently verifying this is difficult.

What are the potential effects of the 2006 Act changes on customers?

80 Whilst the focus of this study has been on lenders, we also asked the businesses we spoke to about how they thought their customers could be impacted by the proposed timetable for implementation of the 2006 Act. The lenders highlighted a number of risks that could impact customers. These risks were linked to:

- The nature of the draft SI – for example, where lenders felt the draft Regulations could be confusing; and
- The consequences of implementing the requirements – for example, around increased costs.

81 It should be noted that we did not uncover any evidence that was based on direct trials with customers or potential customers. Whilst some lenders conduct quite extensive usability testing, they were not able to assess correspondence driven by the 2006 Act because the project was not sufficiently advanced to have generated sample letters for analysis.

82 We did not ask consumer focused organisations to give evidence on the potential impact as this fell outside the scope of our study.

Potential confusion

83 Discussions with lenders revealed that for several of the requirements, as they currently stand, they felt there is limited customer benefit. Or, in some cases, the lnders felt that the requirements actually would lead to more confusion rather than increase transparency. For example, the Notice of Sums in Arrears is not required to be synchronised with debt management procedures. This may mean that arrears notices must be sent out in spite of and taking no account of any existing agreed debt management arrangements.

84 Similarly, some of the information requirements will need a substantial amount of financial awareness or significant amount of explanatory guidance in order to be useful to the customer. This is the case in particular for some more sophisticated financial products tailored to specific customer situations, such as for example, index tracking interest rates, payment holidays on loan agreements, or study loans. For these products, it is difficult to see how the required information could be supplied (e.g. applicable interest rates). Furthermore, the lender would not be permitted to supply additional explanation, as this would fall foul of the requirements relating to interspersal.

Customer irritants

85 Lenders also pointed to some adverse consequences of the proposed requirements – for example, the letters that will continue to be sent to families of deceased persons, or addresses that are known to have changed. Similarly, the lack of clarity around default notices could potentially lead to both pre and post default notification communications to comply with the Banking Code and the 2006 Act, a duplication with limited benefit to the consumer.

Cost pass through

86 As illustrated above, lenders will face large costs in implementing the detailed requirements of the 2006 Act – the costs are larger than the initial estimates and likely to increase further. It is reasonable to assume, and it has been stressed by most lenders, that some, if not all, of these costs will be passed on to customers through higher interest rates and/or fees, rather than absorbed by the lenders' shareholders. For example, lenders' response to the OFT's ruling in April 2006 on default fees charged on credit cards may be seen as evidence of how costs can be passed through to customers. It seems likely that interest rates have probably risen, and the number of providers offering 0% balance transfer periods has fallen.

87 Furthermore, lenders felt that the costs associated with implementation were not always proportionate to the increase in consumer benefits. For example, the requirement for default fees to be charged 0% for

28 days then for simple interest to accrue is felt by almost all lenders to be very challenging. However, one lender told us that the difference between compound and simple interest for a typical £12 default sum over a year was a difference of 5p.

Reduction in product choice

88 Several of the lenders also indicated that, in order to comply with the 2006 Act, they have considered withdrawing certain products from the market, either temporarily or permanently. This is likely to have a disproportionate impact on both the highly indebted and high net worth ends of the consumer lending spectrum. Both these groups tend to require highly flexible and customised products but, as argued above, it is exactly these kinds of products for which certain data elements are more complicated to define or compute. Although business lending is not regulated by the 2006 Act, some lenders felt that some micro-business customers are likely to hold a more personalised and consolidated portfolio of personal *and* business loans. These individuals might experience a reduction in products and the amount of consolidated reporting that can be offered to them.

89 As lenders are significantly less well prepared for implementing the 2006 Actfor buy-to-let mortgages, as a consequence, the impact on consumers from this product is potentially much larger than for other products. Some lenders have indicated that they would almost certainly have to temporarily withdraw some of their products from the market until they had made systems changes to comply with the 2006 Act. Others would seriously have to consider a complete withdrawal, given the costs of making non Consumer Credit Act systems compliant. Similarly, some of their products offering more flexibility and attractive repayment schedules would actually be completely withdrawn as they would not be profitable under the 2006 Act. The consumer would be negatively impacted if he is no longer in a position to trade off more flexibility against slightly higher interest charges and if substantial systems modification costs will be passed on.

90 Moreover, there are potentially some significant wider ramifications for the rental market. If the supply of buy-to-let mortgages decreases, so will the supply of rental accommodation which in turn could drive up rents.

Customer service

91 Lenders felt that the testing phase was very important in the implementation process but if the timetable for implementation was very tight, it was possible that the testing period would be reduced (as the mail source of contingency time). Any failure to properly test the systems could lead to inaccurate information being generated, inappropriate communications or even system collapse. Any of these issues would have strongly negative effect on customer service levels.

92 Lenders were concerned that consumers might also experience a reduction in the service provided to them due to the increase in potentially inconsistent or inappropriate communications. Some lenders suggested the prescriptive and legalistic style of some of these communications required by the 2006 Act may be perceived stressful and difficult to understand.

93 Moreover, if timescales are significantly compressed, some lenders will be forced to de-prioritise thorough testing, or other change programmes, both regulatory as well as business initiatives, which could indirectly affect the quality of services offered to the consumers.

How will each of the seven post-contractual information obligations impact on lenders?

Introduction

94 This part of the section sets out what were identified as key concerns during our data gathering with lenders.

95 It also covers some of the mitigating actions that could be taken by DTI to reduce the impact on lenders, and any consequential impact on the policy intention. This mitigation typically relate to the following actions:

- Clarity;

- Simplification;
- Transitional arrangements;
- Removal; and
- Timing.

Requirements for the form and content of fixed-sum credit account periodic statements (Section 6 of the 2006 Act)

Issues

96 This requirement will create the most significant issues for all the lenders we spoke to. Whilst statements are issued currently for a variety of other products (for example, mortgages, current accounts and credit \cards), there is n\o existing requirement to issue statements for fixed sum credit accounts.

Data availability and integrity

97 Many lenders had concerns around the availability of the data required to be included in the fixed sum statements for their back book of accounts. For example, lenders may not track the original loan amount, the start date of the agreement and contact details for all account holders (such as all partners in a partnership). Acquiring this information would either require searching manual records which could be very resource intensive - one bank told us they estimated this would take 2 man days per account. In some cases, where no manual records existed, it would be impossible to track down the required information. In these cases, it would not be possible for the lender to comply with the requirements, and thus the agreements would become unenforceable.

Clarity of requirements

98 Many lenders expressed concern about a number of points of clarity, such as:

- The requirement to state payments made and the amount becoming due was felt to be confusing. Financial statements typically show the debits and credits on the account rather than sums falling due. As currently drafted, lenders would not be able to provide additional information which might improve customer comprehension. This is because of the 2006 Act interspersal requirements, which are designed to ensure that information is presented transparently without extraneous information that could confuse consumers. So, for example, the draft SI would not allow a statement to show when payment has been returned (e.g. a cheque has not been honoured);
- The requirements for dynamic information, such as the estimated end date of the loan. For example, some products offer payment holiday periods which may affect the end date. Also, customers on debt management plans may be making infrequent payments of differing amounts – estimating when the loan will be complete would be difficult if not impossible if different amounts are paid off.
- Some lenders felt that the requirement to issue statements within a year meant that they would be required to issue statements that covered less than 12 months i.e. issuing the statement at, say, week 50 rather than week 52. This is unlikely to meet consumer expectation – for example, mortgage statements cover a 12 month period. One lender was considering issuing 6 monthly statements as a way of meeting the requirement, but this would double the running cost of the obligation. This approach could have a significant cost impact – it was estimated that each statement costs 30p to send.

Deceased and gone aways

99 Furthermore, the majority of lenders we spoke to were very concerned about the requirement to provide statements to all customers, including those that were deceased or marked as ‘gone away’ - this concern applies to all of the post-contract information obligations covered by this study.

100 Failure to comply with the obligation will make the agreement unenforceable. But the reputational impact of continuing to contact customers known to be deceased could be considerable. Repeatedly sending personal information to previous addresses is likely to have data protection and security implications, for

example, it may provide sufficient information to allow for identity theft. One lender we spoke to was proposing to send a covering letter for these communications stating that whilst the organisation was aware that the customer was deceased or gone away, it was under a statutory requirement to continue sending communications.

Mitigation

Clarity

101 A number of clarifications could be introduced; none of which would be expected to impact the original policy intention:

- The SI could be drafted to clarify a number of key areas, for example, setting out if 'start date' refers to the date the agreement was signed or the date that the loan was drawn down;
- The requirement to state the applicable interest rate could be linked to the period of the statement;
- Lenders have different interpretations on what is required by the right to settle early; clarification would be useful; and
- It would be helpful if DTI could indicate if statements should be provided within a year or shortly after the end of the year (but this ambiguity comes from wording in the Act itself so any change would require primary legislation). However, clear guidance from DTI would be constructive.

Simplification

102 Requiring the statements to show debits and credits (rather than just payments) would reduce ambiguity and present the information in a form that consumers were more likely to understand. This would also reduce the implementation burden on lenders because it is closer to what they already provide for other accounts. Moreover, this approach would exceed the policy intention, as consumers would get information they would be more likely to understand.

103 Lenders felt that the provisions associated with the estimated end date of the loan could be simplified. For example, substituting generic wording around "making minimum payments will mean that it will take longer to pay off the loan" or replicating the period of the loan as set out in the initial agreement. This would enable lenders to meet the core policy intention of indicating to consumers how long the agreement has to run. The policy intention would be slightly reduced for those customers making regular payments (where it might be possible to estimate the end of the loan period), but the approach would be similar to the requirements for other products e.g. credit cards.

Transitional arrangements

104 The obligation to provide statements could only apply to agreements that are signed on or after the commencement of the provisions. This would enable lenders to exclude their back book from the implementation programme, which would considerably reduce risk and complexity whilst ensuring that new agreements comply. This kind of approach has been used in other consumer credit legislation (such as the Consumer Credit (Early Settlement) Regulations 2004). New customers would be able to receive full statements, but existing customers would not receive these statements.

105 However, one lender told us that this type of transitional arrangement would not be helpful. They felt this would increase system complexity (because accounts would have to be 'tagged' to indicate if they were in scope or not). This lender would prefer all accounts to be covered after commencement. Another lender said they would not need this type of transitional provision, as their systems hold the required information on all accounts.

106 However, these views were not shared by the majority of lenders we spoke to. Even with this kind of transitional arrangements, it may not be possible to send statements to at least some of the back book. The scale of this problem associated with missing information is not currently known, but it is clear that many banks would struggle to provide the information required for the some of the back book. Thus, without transitional arrangements, it seems likely that some percentage of the back book of loans would become unenforceable.

Removal

107 The requirement to issue information to deceased or 'gone away' customers could be removed. This would not have a significant requirement on lenders' implementation projects because most of them already have procedures for identifying these customers. With regards to the original policy intention, this change would stop consumers from receiving irrelevant or unwanted communications. If a customer has moved away, then the new residents are unlikely to want to receive repeated mailings to someone who no longer lives at the address. Also, the relatives of deceased customers may find it upsetting to receive repeated correspondence addressed to the deceased. On the other hand, if this obligation was removed, it might allow banks to enforce agreements when, in some circumstances, consumers were not given specific information.

Timing

108 A large majority of lenders had a high degree of concern for delivering implementation in April 2008. In comparison, a majority of lenders felt a low or medium degree of concern for October 2008. In discussion, the concerns were based around this was a completely new activity that would impact millions of customers – extensive testing and regression testing would be required to ensure that the systems were resilient and accurate. Extending the implementation timetable would preserve the policy intention, but delay the realisation of consumer benefits from greater transparency. The lenders that decided to start implementation before the final SI were laid had some concerns that their access to project resources may be affected by any delay – but their degree of concern at delivering in April 2008 versus October 2008 was consistent. It was not clear if they would face additional costs if implementation was delayed.

Requirements for the form and content of running-account statements (Section 7 of the 2006 Act)

Issues

Overdrafts

109 There is a surprising degree of confusion between lenders about whether overdrafts fall within scope of the 2006 Act. Generally, overdrafts have not been regulated by the Consumer Credit Act. However, for those lenders who felt that overdrafts might be covered, there was agreement about the level of effort required to implement this change for current accounts compared to the benefit received. They felt that there was considerable effort because of the age of systems in this area and the sheer number of accounts involved (one lender told us that some 224,000 customers a month use a current account overdraft) which means an extended and complex testing process. However, other lenders felt that because overdrafts are not treated as consumer credit, they would only fall into the new requirements if a default notice was issued. They accepted the need to make the arrears change but queried the consumer benefit of including current accounts in the statementing change.

110 Furthermore, the mandatory terminology (around missed payments and minimum payments) was felt to have little or no resonance for overdrafts – which are only generally repayable as one-off sum on demand, rather than as a series of regular payments.

Other points

111 Another lender felt that the interspersal requirement would make it difficult to set out where different interest rates applied during the statement period. This had potential to cause customer confusion.

112 Lenders that comply with the Banking Code and APACS guidelines have been required previously to state the impact of making minimum payments and the allocation of payments. Under the Regulations, this would become a statutory duty. However, a number of firms felt they would have to make changes to their statement design to take account of the new requirement (and interspersal requirements), even though it was in practice identical to one that had previously been adopted.

113 Again, lenders were concerned about the requirement to contact customers that were deceased or marked as 'gone away' in order to enforce the agreement – please see 99 to 100 for more details.

Mitigation

Clarity

114 Lenders felt that revised drafting could helpfully set out how the requirement to state the impact of making minimum payments would interact with Banking Code requirements. A change of this nature would make reduce the challenge for business implementation. It would not impact the policy intention, and arguably reduce consumer confusion.

Simplification

Lenders did not highlight any specific points here.

Transitional arrangements

Lenders did not highlight any specific points here.

Removal

Lenders did not highlight any specific points here.

Timing

115 A large majority of lenders expressed a high degree of concern about implementation in April 2008. A large majority expressed a low or medium degree of concern for October 2008 implementation. A longer timetable would preserve the policy intention, but delay the realisation of consumer benefits from greater transparency. The lenders that decided to start implementation before the final SI was laid had some concerns that their access to project resources may be affected by any delay – but their degree of concern at delivering in April 2008 versus October 2008 was consistent. It was not clear if they would face additional costs if implementation was delayed.

Requirements for the form and content of notices of sums in arrears for fixed-sum credit agreements etc (Section 9 of the 2006 Act)

Issues

116 Most lenders we spoke to felt this proposal could have very significant business process implications and customer communication issues.

System implications

117 The trigger for sending a Notice of Sums in Arrears is not like any other used by lenders. The Regulations require a Notice of Sums in Arrears to be sent when the customer is in arrears by an amount that equals the total of two repayments. For example, if a customer is required to make monthly repayments of £100 but actually pays £50 instead, the lender would be required to send a Notice of Sums in Arrears after 4 months when the arrears totalled £200. In practice, the lenders we spoke to would generally contact a customer after one missed payment or part payment, unless they were covered by a debt management plan where they would not be contacted provided they were making the required payments.

118 Therefore, lenders will need to make changes to their core systems and also to review their strategy for communicating with customers in arrears. Whilst almost all lenders had concerns about calculating the details of missing payments, most lenders seemed more concerned about the communications and process impact rather than the systems modifications, covered in more detail below.

Impact on customers

119 Lenders felt the obligations set out in the draft Regulations could have a negative impact on customers, particularly those on existing debt management plans. For example, a lender may agree with a customer in financial difficulties that he/she can make significantly reduced payments over a period of time. However, the draft Regulations of August 2006 would require the lender to issue a notice of sums in arrears even though the customer was meeting the reduced requirements agreed with the customer as part of a debt management plan. It was widely felt that this would either confuse and distress customers. One bank we spoke to was planning to send out the notice with a covering letter stating that whilst the lender was aware that the customer was in debt management, it was required by statute to issue a notice but the customer should ignore it. Encouraging consumers to disregard arrears notices does not fit very well with the Government's longer term policy on tackling indebtedness.

120 In addition, lenders felt there was also a risk that consumers could be bombarded with repeated letters –

several banks we spoke to contact customers after each missed payment (rather than the two required by the Regulations) – thus missing two payments could lead to three notices being sent (two for each missed payment, and one for the notice required by the Regulations). This will have cost implications, and the customer may feel they are being harassed by the lender. One lender told us they planned to manage this risk by holding a complete review of their letter strategy to ensure that they were treating customers fairly and were not harassing them. This would require building a business process to ensure that customers still receive important information in a timely manner. It may be the case that rogue lenders do not currently supply the information required by the draft Regulations, however, this was not so for the lenders we spoke to, so the additional requirement imposed by the Regulations will be duplicate existing processes.

121 Moreover, a few banks noted that the prescribed wording for the notice was not consistent with the communication style that they used with their customers – it was too formal and intimidating.

OFT information sheet on arrears and defaults

122 The draft Regulations set out that when sending the Notice of Sums in Arrears, the lender must include an OFT information sheet. Lenders have identified a number of concerns around this requirement.

123 The lack of information on the physical nature of this leaflet and the manner in which it must be supplied are a concern. It is not clear if the leaflet will be a separate document to be inserted into the envelope, or if it could be printed by the lender themselves. Consumer groups have a clear preference for it to be separate but this has a much higher impact on the lenders change effort because of printing and posting issues. The physical size and weight of the document may have practical implications for existing distribution arrangements – for example, a large leaflet may not fit in standard sized envelopes. This would increase costs. We understand that OFT has said that they will begin informal consultation in the autumn, but has not yet committed to a firm timetable. Lenders have stated that this timetable may be too short if significant changes to document handling processes or revised letters are required.

124 Furthermore, lenders are particularly concerned that they will not be entitled to charge interest or default sums nor enforce the agreement if the OFT leaflet is not included. It is not clear how the lender will be able to demonstrate proof that the leaflet has been either sent or received. They feel it may encourage consumer gaming, such as claiming that the leaflet was not included with the notice. It is not clear if the lender would have to prove that the leaflet was sent, or the consumer would have to prove that the leaflet was not received.

Other issues

125 A few lenders were concerned about the requirement to provide advice on the right to apply for a time order. Some felt this would encourage more consumers to apply for time orders. Others had concerns about the drafting being inconsistent with the Consumer Credit (Enforcement, Default and Termination) Regulations 1983; it may also duplicate advice in the OFT leaflet.

Mitigation

Clarity

126 A number of clarifications would help lenders deal with implementation without impacting the core policy intention:

- Lenders are keen to get information on the nature of the OFT sheet as soon as possible: OFT could commit to a consultation timetable to allow lenders to manage this risk; and
- The requirement to provide advice on the right to apply for a time order could be clarified by adopting drafting consistent with the 1983 Regulations and the final form of the OFT leaflet.

Simplification

127 A number of measures could be adopted which would preserve the core policy intention whilst enabling lenders to enforce agreements.

- The prescribed wording and timing for the notice could be replaced by a generic duty to provide

information on the key points – this would allow lenders to tailor the notice to the needs of their customers, and possibly mean that this could be incorporated into existing letters. This would minimise the systems change required, and ensure that customers received sufficient but not excessive notification of arrears; and

- If the OFT supplied text that could be directly printed on the default notices by lenders then the probability of claiming that the information was not received would reduce. Alternatively, the warning that the agreement is not enforceable if the leaflet is not received could be removed or redrafted. For example, generic text could be included to state that if the leaflet is not included, the customer should contact the lender immediately. The policy impact of this is likely to be insignificant – there may be a number of cases where agreements are enforced although the leaflet was not received, but this risk could be mitigated if lenders could directly print the specified text on their own documentation.

Transitional arrangements

128 If the transitional arrangements for this requirement included an exemption for customers on existing debt management plans, it would ensure that they were not confused by conflicting information.

Removal

129 Lenders did not highlight any specific points here.

Timing

130 A large majority of lenders had a high degree of concern about delivering implementation for April 2008. This was related to the requirement to introduce a new threshold for the Notice of Sums in Arrears, testing the impact on customer accounts, and the risk associated with the OFT's leaflet. A large majority felt a low or medium degree of concern about implementation for October 2008. The lenders that decided to start implementation before the final SI was laid had some concerns that their access to project resources may be affected by any delay – but their degree of concern at delivering in April 2008 versus October 2008 was consistent. It was not clear if they would face additional costs if implementation was delayed.

131 Implementation could be delayed until October 2008 – this would allow lenders more time to complete rigorous testing of systems and communication changes. This would result in a delay to consumer benefits, but may be offset by clearer communication after the delay, for example, customers on a debt management plan might not receive conflicting information.

132 Furthermore, OFT could commit to a consultation timetable that would allow lenders to have greater certainty on when they would have to make decisions on their document handling processes. This would not impact the underpinning policy intention.

Requirements for the form and content of notices of sums in arrears for running-account credit agreements (Section 10 of the 2006 Act)

Issues

133 Most lenders we spoke felt this proposal could have significant business process implications and customer communication issues. See paragraphs 116 to 125 for details.

Mitigation

Clarity

134 See paragraph 126 for details.

Simplification

135 See paragraph 127 for details.

Transitional arrangements

136 See paragraph 128 for details.

Removal

137 Lenders did not highlight any specific points here.

Timing

138 Almost all the lenders we contacted felt a medium or high degree of concern for delivering implementation in April 2008. However, for an October 2008 implementation date, almost all felt a low or medium degree of concern. A longer timetable would preserve the policy intention, but delay the realisation of consumer benefits from greater transparency. The lenders that decided to start implementation before the final SI was laid had some concerns that their access to project resources may be affected by any delay – but their degree of concern at delivering in April 2008 versus October 2008 was consistent. It was not clear if they would face additional costs if implementation was delayed.

Requirements for the form and content of the notices of default sums and prescribing the period for service (Section 12 of the 2006 Act)

Issues

139 The new interest charging regime associated with default sums creates significant technology difficulties for almost every lender we spoke to.

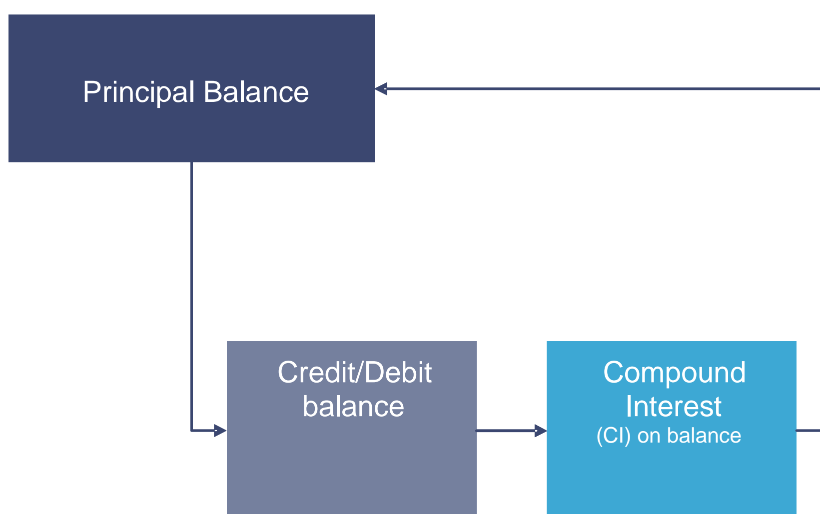
System implications

140 Under the 2006 Act, if a lender levies a default sum then interest cannot be charged on it for 28 days. Then, after 28 days, only simple interest can be charged on the default sums.

141 Implementing this requirement essentially requires the bank to set up sub-accounts to allow different interest rates to be charged on different elements of the amounts due. These sub-accounts are known as 'buckets' or 'pots'. This kind of account structure is widely used in the credit card market, and we did not find any evidence that it is used for any other kind of consumer credit.

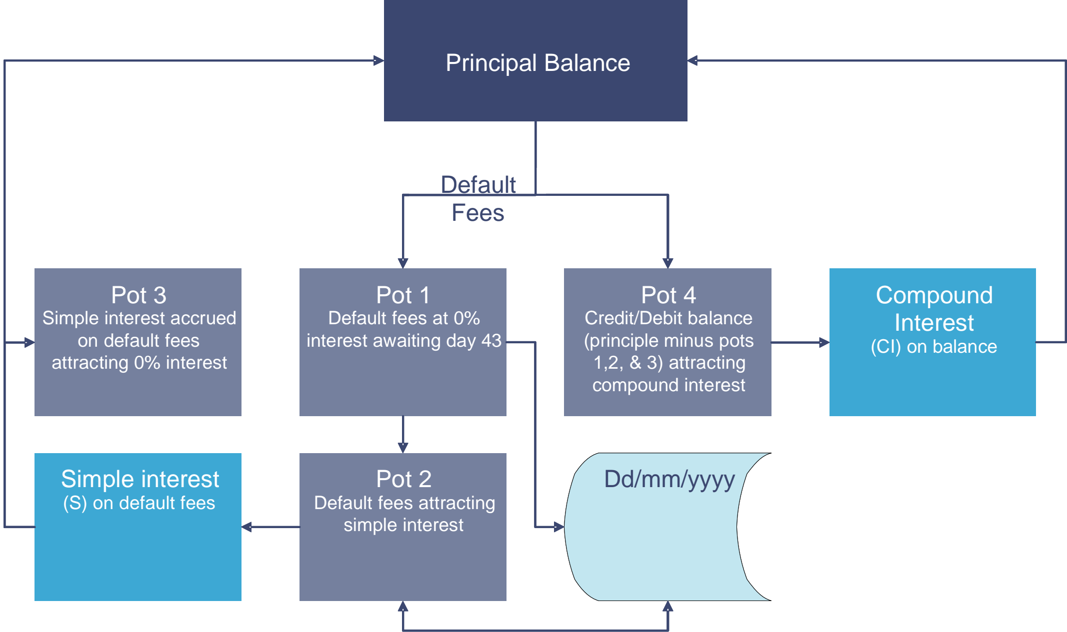
142 One lender explained how accounts are structured at the moment:

Figure 6 – Typical current account structure



The requirements imposed by will require the accounts to be restructured as follows:

Figure 7 – Proposed current account structure to take account of the requirements of the 2006 Act



143 This requirement to retrofit a 'pot' structure to all accounts is a considerable technical challenge affecting millions of accounts. However, whilst the lenders had significant concerns about the interest free period, they identified more difficulties with the requirement to charge simple interest rather than compound interest after the expiry of the interest free period.

144 Charging simple interest on default sums requires totally new functionality to that which is currently used. It will require major changes to all lenders' core systems. Whilst credit card accounts make use of the 'pot' structure, the requirement to use simple interest is completely new even for this class of consumer lending. It is worth noting that whilst the lenders face significant costs from system changes, the benefit to the individual consumer may be negligible – one lender told us that the difference between compound and simple interest for a typical £12 default sum over a year was a difference of 5p

145 Change of this scale creates a high level of risk, as these systems are both very complex, in many cases very old (typically more than 30 years old), and core to the lending business. For example, systems could crash, or consequential changes might be required in dozens of other supporting applications. Mistakes could be significant, both to the lenders and the customers. For example, lenders may overcharge or undercharge interest. This reinforces the importance of sufficient time to test and regression test all systems.

146 However, one lender said they did not charge default sums. Instead, their credit agreements entitled them to levy additional sums to cover administration. They therefore felt that section 12 would have no impact on their business because they did not charge default sums. However, the ongoing OFT enquiry into current account fees may come to conclusions that do not support this stance.

Other issues

147 Furthermore, there were some concerns about the level of clarity relating to the requirement to send default notices. The Banking Code sets out that customers should be notified *before* sums are debited, and this approach is continued in the 2006 Act. However, the draft Regulations imply that the notice should be sent *after* the sums have been debited. Therefore, as drafted, there is a risk that customers will receive pre-notification *and* post-notification of a default charge which may lead to confusion and require additional cost at little extra benefit.

148 Lenders were also concerned about the requirement to contact customers that were deceased or marked as 'gone away' in order to enforce the agreement – please see paragraphs 99 to 100 for more details.

Mitigation

149 There are a number of potential actions that could be undertaken to enable the policy intent to be realised whilst reducing the implementation burden. However, it is important to note that the requirement to adopt an interest free period and subsequently charge simple interest sits on the face of the 2006 Act, rather than in the Statutory Instruments or other guidance. Therefore, it would not be possible to modify the requirement by reworking the draft SIs.

Clarity

150 The Regulations could be amended to make it clear that pre-notification only is required.

Simplification

151 It would be possible to amend primary legislation to simplify the requirements for lenders. For example, the requirement to charge only simple interest could be removed. This would enable lenders to avoid complex, high risk development work in a very limited time period. However, it would mean that the core policy intention was only partially met.

Transitional provisions

152 Lenders did not highlight any specific points here.

Removal

153 It would be possible not to commence this provision in its entirety. That would permit the lenders to avoid one of the more complex, high risk requirements in the new 2006 Act regime. However, this would mean that the core policy intention of the 2006 Act were not met, that is, consumers would not benefit from an interest free period on default sums, and any default sums would be charged compound interest.

Timing

154 All the lenders we spoke to had a medium or high degree of concern over implementing these changes for April 2008. However, a large majority felt a medium degree of concern over implementing in October 2008, although this did vary by product. One lender stated that they felt they were at a high risk of not being compliant for current accounts even at October 2008 because of the size and complexity of the change required.

155 A longer timetable would preserve the policy intention, but delay the realisation of consumer benefits from greater transparency. However, it should be noted that the different between simple interest and compound interest over 6 months is potentially significant. Yet, this is minimised by the fact that many lenders have payment allocation routines that first pay off default sums – thus, the default sums are less likely to be subject to interest at all.

156 It may be possible for this requirement to be commenced at a different time to other provisions in the 2006 Act – for example, April 2009.

157 The lenders that decided to start implementation before the final SI was laid had some concerns that their access to project resources may be affected by any delay – but their degree of concern at delivering in April 2008 versus October 2008 was consistent. It was not clear if they would face additional costs if implementation was delayed.

Amendments to the existing Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983 (SI 1983/1561) on the form and content of s.87 Default Notices (Section 14 of the 2006 Act)

Issues

158 Lenders were concerned about the requirement to contact customers that were deceased or marked as ‘gone away’ in order to enforce the agreement – please see paragraphs 99 to 100 for more details.

159 Lenders had concerns about the OFT information sheet – see paragraphs 122 to 124 for more details.

Mitigation

Clarity

160 Lenders did not highlight any specific points here.

Simplification

161 Lenders did not highlight any specific points here.

Transitional arrangements

162 Lenders did not highlight any specific points here.

Removal

163 Lenders did not highlight any specific points here.

Timing

164 Around half the lenders we spoke to expressed a medium or high level of concern about implementation in April 2008. A large majority of lenders felt a low level of concern about implementation in October 2008. A longer timetable would preserve the policy intention, but delay the realisation of consumer benefits from greater transparency. The lenders that decided to start implementation before the final SI was laid had some concerns that their access to project resources may be affected by any delay – but their degree of concern at delivering in April 2008 versus October 2008 was consistent. It was not clear if they would face additional costs if implementation was delayed.

Requirements for the form and content of notices in relation to post judgment interest (Section 17 of the 2006 Act)

165 Most lenders we spoke to do not currently charge post judgement interest.

166 A small number of lenders had some concerns about this requirement, mainly connected to the rate at which interest could be charged (and any impact from variable rates). We did not regard any of these issues as particularly significant because they affect few lenders.

Clarity

167 Lenders did not highlight any specific points here.

Simplification

168 Lenders were concerned about the requirement to contact customers that were deceased or marked as 'gone away' in order to enforce the agreement – please see paragraphs 99 to 100 for more details.

Transitional arrangements

169 Lenders did not highlight any specific points here.

Removal

170 Lenders did not highlight any specific points here.

Timing

171 A large majority of lenders assessed their degree of concern for either April 2008 or October 2008 implementation as 'low'.

4 Conclusions

Introduction

172 In the final section of our report we draw together our key conclusions based on the evidence we have collected during the course of our research. We do so by considering three key questions:

- What are the key concerns of those lenders which will potentially need to comply with the requirements of the 2006 Act and the draft SI?
- How could the concerns of lenders be addressed and what would be the impact on both the lenders and the achievement of the policy intention (i.e. consumer benefits)?
- What are the risks if the draft SI and implementation timetable were to remain unchanged?

Key sources of business concern

173 Based on our discussions with a significant number of the major lenders, it is evident that many, although not all, are very concerned about the proposed requirements within the 2006 Act and the draft SI and the timetable for implementation. To a large extent, these concerns reflect five related factors:

- The potential changes to business systems, largely, but not exclusively, IT systems, required by the regulatory changes are very significant: they go right to the heart of many of the lenders' business processes;
- For the larger lenders, the potential costs of complying with the post-contract information requirements within the 2006 Act and the draft SI are expected to be very considerably in excess of those estimated by the DTI in its Regulatory Impact Assessment: based on the companies we interviewed, we believe that the one-off costs arising from the need to adapt IT systems alone is likely to be at least 40 times that estimated by the DTI and, for some lenders, well over 100 times the DTI estimate and, in addition, there will be significant recurring costs as a result of lenders' need to deliver additional documents to their customers;
- Business remains uncertain about the precise scope and form of the regulatory requirements: for example, it has only recently become clear that buy-to-let mortgages are likely to fall within the scope of the 2006 Act as it is currently drafted and, in other cases, the precise content and form of information which must be provided to customers are viewed as sufficiently ambiguous or unclear;
- For the majority of the businesses interviewed, the nature and scale of the business uncertainties has meant that they have been unable/unwilling to proceed to the point where they can start to develop a detailed plan for implementing the changes required to comply with the 2006 Act without taking an unacceptable risk that at least some of their work could be wasted by further regulatory changes: given the (high) opportunity cost of the resources involved, this is a risk which some lenders are unwilling to take despite the potential significance of any failure to comply with the SI; and
- The changes arising from the 2006 Act are quite unlike other regulatory changes which the industry has had to address in recent years, for example those linked to the Consumer Credit Act regulations in 2004 and MCOB: the proposed changes are much wider ranging and require fundamental alterations to core business processes.

174 Through our discussions with lenders and our review of the consultation responses, we have identified a long list of specific concerns in relation to the information requirements set out in the draft SI. These have been discussed at some length in the previous section. In summary, the key concerns are:

- The need to introduce simple interest alongside compound interest: for many of the lenders, adapting their IT systems to allow simple interest to be calculated adds significantly to the costs of compliance;
- The unavailability of the required information: lenders highlighted a number of items of information required under the draft SI which they did not currently have on their systems and which, in many cases, they would need to extract manually from other systems or files at considerable cost;
- The treatment of deceased and 'gone aways';
- The ambiguity of certain requirements: lenders identified several instances where they were unclear about the precise requirements envisaged within the draft SI;
- The potential conflict between the requirements within the draft SI (from August 2006) and other regulatory requirements;
- The lack of availability of specialist resources to support implementation;
- The possibility of customer confusion: many lenders expressed concern that the type and form of communication required by the SI would add to their customers' confusion rather than improving transparency as intended; and
- The lack of time for implementation: very few of our interviewees thought that they would be able to implement all the system changes required within 12 months of the SI being finalised without adopting an approach to programme implementation which would expose them to levels of risk of system failure which they regarded as unacceptably high.

175 In summary, based on our research and analysis, we believe that the scale and complexity of the changes required of lenders by the draft of the SI from August 2006 mean that it is most unlikely that they will all be able to comply the requirements by April 2008.

Potential implications of alternative DTI responses to business concerns

Potential DTI responses

176 Given our conclusion about the feasibility of lenders complying with the requirements in the draft of the SI by April 2008, we have examined the potential ways in which businesses' concerns might be addressed and their likely impact both on lenders and on the overriding policy intention behind the 2006 Act.

177 Through our discussions, we have identified and evaluated three broad options for addressing lending businesses' concerns. These are:

- Amending the SIs to:
  - clarify the precise requirements;
  - simplify the existing, proposed requirements; and
  - introduce transitional arrangements whereby new consumer credit agreements are treated differently from existing agreements: this might involve either seeking to exempt existing agreements from the scope of the SI or alternatively allowing business longer to comply with the obligations in respect of their existing business;
- Altering (i.e. extending) the implementation timetable for the draft SI; and
- Removing specific requirements, recognising that this may require primary legislation, for example a Regulatory Reform Order: based on the evidence from our work, such an Order might need to cover

two main areas:

- The products which are within scope of the 2006 Act: at present, buy- to-let mortgages will fall within scope of the 2006 Act although many lenders have not anticipated that this would be the case and, as a direct result, they have made far less preparation for implementation, added to which their business means that they are largely unfamiliar with the requirements of consumer credit regulation; and

- The requirements to charge simple interest, rather than compound interest, on default sums.

Potential implications of alternative responses to business concerns

178 Table 6 below provides a high level assessment of each group of responses in terms of their potential impacts on the compliance costs faced by lenders and on the likelihood of the policy intention being achieved. The analysis reflects only the issues linked to complying with the SI by those businesses which have been in scope of the 2006 Act previously: it does not capture the potential impact if buy-to-let mortgages were to fall within scope.

179 The key conclusions which we draw from our research are as follows:

- Measures which would clarify and simplify the requirement would have a positive impact on lenders by reducing their costs of compliance and meeting some of their anxieties about the potential confusion that might be caused by the information they are being asked to provide to consuers: in this sense, they would be a clear ‘win-win’;

- The impact of introducing transitional arrangements would also have a positive impact on lenders by significantly reducing their costs of compliance but would put at risk some of the expected policy benefit by (temporarily) excluding existing agreements from scope and thus removing the obligation to provide some consumers with (additional) information;

- Similarly, extending the timescale for implementation of the 2006 Act by at least six months would have a mixed impact: it would make it more likely that all major lenders could be compliant but would potentially defer realisation of the consumer benefits; and

- Taken together, however, we believe that amendments to the existing SI would still leave lenders facing disproportionate costs relative to the expected benefits for consumers, recognising that preparation of this report has involved no direct consultation with consumers.

180 In summary, the various options to improve the clarity and simplicity of the requirements and to provide transitional arrangements offer the scope to reduce lenders’ costs significantly whereas extending the timing for implementation is more likely to significantly reduce the risks of programme failure.

Table 7: Evaluation of alternative responses

	Impact on lenders	Impact on policy intention
Clarity	Positive impact - reduces cost • Reduces implementation burden • Ensures lenders adopt a common approach	Moderate positive impact • Easier for customers to make comparisons between lenders – confusion reduced
Simplification	Strong positive impact – reduces cost • Significant reduction in implementation burden, particularly for dynamic information requirements	Varied impact • Would improve the outcome for consumers in some cases e.g. showing debits and credits on statements • Would reduce transparency for consumers in other cases e.g. estimated loan date
Transitional arrangements	Very strong positive impact – reduces cost • Very significant reduction in	Some negative impact • New customers would receive all

	Impact on lenders	Impact on policy intention
	implementation burden • Allows lenders to enforce existing agreements (where missing data would otherwise prevent that)	information; existing customers would not • Unlikely that the policy intention was that a large percentage of back book would be unenforceable
Timing	Strong positive impact – reduces risk • Permits greater testing so reduces risk of failure	Some negative impact • Benefit realisation would be delayed by 6 months
Removing key provisions	Strong positive impact – reduces cost and risk • Very significant reduction in implementation burden	Strong negative impact • Very significant – policy intention not met at all

181 In summarising our conclusions, we believe it is also useful to consider how far the evidence from our work suggests that the draft SI and associated timetable is consistent with the Better Regulation Task Force's *Principles of Regulation* and how far the alternative responses would be consistent with the same principles:

- Proportionality: in our view, on the basis of the evidence we have been given by the lenders, the costs of the draft SI are disproportionate to the anticipated benefits and all of the potential measures we have considered would go some way to making the expected burden of regulation more proportionate to the anticipated consumer benefits: it is important to recognise that we have not examined evidence from consumer bodies in reaching this view;

- Accountable: we believe that the requirements as drafted in August 2006 do not respond to consumer need and business practice as well as they might but could be improved by relatively straightforward amendments;

- Consistent: evidence from our research suggests that the draft SI is not consistent with other Government initiatives although the concerns of lenders could be largely addressed by amending the draft SI to take account of the clarity and simplification points discussed above;

- Transparent: we believe that further work is needed to clarify some aspects of the draft SI for business to ensure that those affected can understand and comply with the new requirements; and

- Targeted: we believe that the draft SI is not yet as targeted as it could be and that in some places the SI could be amended to reduce the level of prescription and detail such that lenders do not face unnecessary burdens.

Risks

182 In order to understand fully the potential implications of the alternative responses discussed above, we believe it is also important to consider the implications if the DTI were to 'do nothing' to the draft SI, save perhaps to remove some of the potential ambiguities. This part of our conclusions assesses the potential risks of going ahead with the SI as drafted in August 2006 with a timetable for implementation by April 2008.

183 In summary, we believe that there would be four key risks:

- Some major lenders could be non-compliant with the 2006 Act in 2008;

- Consumers could face higher costs and less product choice;

- The information provided to consumers could add to, rather than reduce, possible confusion; and

- There could be continuing legal uncertainty as case law evolves.

184 We consider each risk in turn below.

Non-compliance

185 Based on the evidence we have collected, we consider it is likely that at least some of the major lending institutions will be unable to comply with the draft SI by April 2008, especially if the final draft of the SI is not available until April 2007. In these circumstances, lenders could respond by forgoing interest on some elements of their agreements until they are in a position to comply with the requirements. Alternatively, it is quite likely in our view that some lenders will temporarily withdraw at least some of their products from the market. This would adversely affect some indebted individuals.

186 A further alternative is that some lenders may consider accepting the risk of penalties for non-compliance. In practice, however, this option seems less likely to be taken because the potential penalties are quite substantial and the associated reputation risk is also significant.

187 A variant on this option would be if some lenders were to prioritise the development of those systems elements that need to be in place by the go live date (i.e. April 2008) over the build of those elements that need to be in place within the year of implementation, e.g. annual statements which would not be due until April 2009.

Higher costs to customers/reduced product choice

188 We have seen that where lenders reduced their default fees following an OFT investigation into their level, many of them raised their interest rates in order to compensate for the loss of income. Given this, we believe that it is highly likely lenders will seek to pass on a substantial proportion of the additional costs arising from compliance with the post-contract obligations within the 2006 Act to their customers in the form of higher interest rates.

189 Alternatively, to the extent that lenders withdraw (at least) some of their products, this will reduce the choice available to customers and cause a reduction in liquidity. This, in turn, could have wider repercussions on the economy, especially in light of the size of the markets affected.

190 Perhaps the most significant example of this risk can be seen in relation to buy-to-let mortgages. To the extent that these would be brought within the scope of the 2006 Act, our discussions with the lenders indicate clearly that there is a significant risk that some lenders will choose to withdraw from the market at least temporarily and there is every likelihood that some will choose not to return to the market given the costs associated with compliance with the consumer credit regulatory regime.

Customer confusion and disbenefit

191 As noted above, there are several parts of the draft SIs which are ambiguous. In addition, there are other aspects of the SIs, for example certain default sum notices, where it seems highly probable that some customers will find themselves receiving information which, at best, does not improve their understanding of their situation and, at worst, is either confusing or a source of irritation and distress, for example letters to deceased persons.

Legal uncertainty

192 Another risk of not addressing some of the lenders' concerns now would be the increased dependence on evolving case law. Whilst evolving case law can never be completely excluded, increased certainty through statute would, on balance, probably benefit both consumers and lenders.

In the event that, pursuant to a request which you have received under the Freedom of Information Act 2000 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), you are required to disclose any information contained in this proposal, we ask that you notify us promptly and consult with us prior to disclosing such information. You agree to pay due regard to any representations which we may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such information. If, following consultation with us, you disclose any such information, please ensure that any disclaimer which we have included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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