

Distance Marketing Regulations

As if reviewing all marketing materials to ensure they comply with the new Consumer-Credit (Advertisements) Regulations 2004 wasn't bad enough, on 31 October 2004 the Financial Services (Distance Marketing) Regulations 2004 (Statutory Instrument 2004 Number 2095) ("the 2004 Regulations") will also be coming into force David Bowden of Lobby and Law investigates the implications:

James Milligan at the Direct Marketing Association says these 2004 Regulations "create uncertainty for business and it is unsatisfactory to leave the courts to resolve the definition of 'distance contract'".

Despite the fact that they implement an EU Directive which was agreed back in June 2002, HM Treasury laid the 2004 Regulations on 4 August 2004. The Regulations were laid during the long summer recess when they will attract little scrutiny. The UK will be late in implementing the Directive which was meant to be up and running in all the 25 EU Member States by 9 October 2004.

The UK has decided to "copy out" the Directive. This approach has its problems as the Directive itself left many problems unresolved because the European Commission (EC) refused to listen to any lobbying after first reading in the European Parliament.

Jeremy Clivaz in the FSAs Retail Products Division says that most FSA-regulated firms "will have to take concrete steps to understand the nature of the impact on their business and where appropriate, change to their systems and processes and documentation."

There are some major unresolved grey-areas in the 2004 Regulations and they have major implications for the credit and car finance business.

What is a distance contract?

The 2004 Regulations only apply to "distance contracts". There is a definition of these in Regulation 2 (1) which slavishly copies the definition in Article 2 (a) of the Distance Marketing of Consumer Financial Services Directive ("DMFSD") (2002/65/EC). "Distance Contracts" are defined as: any contract concerning one or more financial services concluded between a supplier and a consumer under an organised distance sales or service-provision scheme run by the supplier who, for the purpose of that contract, makes exclusive use of one or more means of distance

communication up to and including the time at which the contract is concluded;

There is no definition of "organised distance sales scheme" in either the draft 2004 Regulations or in the DMFSD itself. Consumers who use the internet or phone around to get the best deal on their car or home insurance will be covered by the 2004 Regulations. Customers who go to their local bank branch to ask about a loan, see an adviser and sign the documentation in the bank branch are not covered by the 2004 Regulations. In between these two situations, there is a very large grey area indeed.

Are credit or hire agreements signed or negotiated at a car dealer's or retailer's or broker's premises regarded as a distance contract?

"The Regulations have implications for the credit and car finance business"

Although the customer has face-to-face discussion with the staff employed by the car dealer or retailer or broker, the customer will rarely meet personally anyone employed by the finance or insurance company involved. Does this mean that the contract is a distance contract?

The Finance & Leasing Association (FLA) lobbied for five amendments at second reading to put this matter beyond doubt. Although all amendments were accepted by the European Parliament's Legal Affairs & Internal Market Committee, at the full session of the Parliament on 13/14 May 2002, all five amendments were rejected.

This is an unsatisfactory state of affairs. HM Treasury was lobbied heavily on this prior to laying of the 2004 Regulations. The Treasury view is that the position is arguable either way and it has therefore ducked the issue lamely and merely copied out the definition from the DMFS Directive. This means that this issue now needs to be determined by either the "competent enforcement authority" (which in the UK will either be the FSA or OFT) or the courts. Regrettably it is not possible to give clear advice as to what products are covered and what are not covered by these new Regulations. The position will get muddier still as we are likely to see 25 different set of rules and interpretations of these across the EU. Although the DMFS Directive has to be reviewed soon (see below), a case

may reach the European Court in Luxembourg before then from any of the 25 EU states and it is not possible to second guess what interpretation the court will give to this messy Directive.

Most credit and car finance businesses will take the cautious view that the 2004 Regulations may apply and will seek to comply with them. As the DMFS Directive's cancellation provisions (which go further than the CCA and give 14 days not five days for all distance contracts) will not apply in the UK yet, this is not of itself unduly onerous but could not have come at a worse time given the pressure on resources on complying with all the other new regulations from the FSA and DTI.

What happens when a broker or intermediary is involved?

Recital 19 of the DMFS Directive says: "the supplier is the person providing services at a distance. This Directive should however also apply when one of the marketing stages involves an intermediary. Having regard to the nature and degree of that involvement, the pertinent provisions of this Directive should apply to such an intermediary, irrespective of his or her legal status."

In the first draft of the Regulations issued by HM Treasury in their July 2003 Consultation Paper the definition of "intermediary" would have meant that the UK Regulations did the opposite of what Commissioner Byrne told the European Parliament the Directive would do! Fortunately, HM Treasury has listened to concerns and the final version of the 2004 Regulations makes the position clearer.

The relevant part is Regulation 6 (2) (b). This says: "these Regulations have effect as if the reference to the supplier in the definition of 'means of distance communication' in regulation 2(1), each reference to the supplier in regulations 7, 8(1) and (2), 10 and 11(3)(b) and the first reference to the supplier in regulation 8(4), were a reference to the intermediary."

Now if we put all this into the definition of "means of distance communication" in Regulation 2(1), then it says: " 'means of distance communication' means any means which, without the simultaneous physical presence of the intermediary and the consumer, may be used for the marketing of a service as between those parties".

This re-worked definition of "means of distance communication" taken together with the definition of "distance contract" in Regulation 2(1) means that in the UK consumer

DISTANCE MARKETING

finance agreements negotiated or signed at a car dealer's or retailer's or broker's premises are not caught by the new 2004 Regulations because there is face-to-face intervention-albeit that it is not the finance company's face that meets the customer's face.

Finance companies relying on this exemption will need to ensure they have engineered their processes robustly to stop a distance contact arising unwittingly. This could happen if a prospective customer called into a car dealer or shop, collected an application pack and then sent it back by post to either the car dealer/shop or the finance company directly.

"Lenders need to engineer their processes robustly"

The Regulations adopt a "country of origin" approach. This means that a UK-based business only needs to comply with the UK rules if marketing cross-border in any of the other 24 EU states. This is not mandated by the Directive itself. If a UK credit or car finance business is marketing credit in Ireland, for example, it will still need to check that the Irish law implementing the DMFS Directive achieves the same result. This is a consequence of the agreed final version of the Directive being a minimum harmonisation measure. It was a maximum harmonisation measure originally up to the first reading stage in the European Parliament.

Hire purchase

Those in the car finance business will remember that we never got a clear answer as to whether hire purchase (HP) was covered by the Consumer Protection (Distance Selling) Regulations 2000 ("the 2000 Regulations"). In a HP transaction the finance company is the actual seller of the vehicle. As the HP transaction is at a distance from the finance company, unless an exception applies the 2000 Regulations will apply and make the HP contract cancellable for 14 days even if it is signed on the car dealer's premises. The exception everyone tries to rely on is that for "financial services" in Schedule 2 to the 2000 Regulations, but it is not clear cut that HP is exclusively a financial services contract. Some motor finance businesses have taken the cautious route and are already complying with the 2000 Regulations.

Has HM Treasury taken this golden opportunity to put this beyond doubt once and for all?

No. So for HP we don't know whether it is covered by the new 2004 Regulations or the 2000 Regulations or both. The Treasury Consultation Document from July 2003 was silent on this issue. There is nothing to accompany the laid version of the Regulations about it.

One possible effective work-around will be to have a combined cancellation notice because the requirement is to tell customers that they have a right to cancel not under which Regulations this arises. This would mean that a possible combined cancellation notice would tell customers that their cancellation period will end seven days after they return a vehicle or 14 days after the motor finance company signs the agreement, whichever happens later. Those companies deciding to go down this route will need assistance in drafting this notice and getting it right.

What about consumer hire agreements?

Not only does HM Treasury not understand HP, but for them the consumer hire, leasing and contract hire businesses seem not to exist either. The difficulties with HP never troubled the leasing industry with the 2000 Regulations because these clearly only applied to "selling" and not "leasing".

The 2004 Regulations apply only to "financial services" which is defined in Regulation 2(1) as "any service of a banking, credit, insurance, personal pension, investment to payment nature." This definition is copied from the DMFS Directive. The amended proposal from the EC in July 1999 which led to the DMFS Directive (COM (1999) 385 Final) had an explanatory memorandum attached. This said: "all references to existing Directives have been removed, in order to ensure that all financial services liable to be offered to a consumer are covered and to avoid the persistence of gaps which would have been the case with the earlier definition."

The definition of "credit" in Regulation 2(1) makes no mention whatsoever of "hire". It copies the definition of "credit" used in Section 9 (1) of the Consumer Credit Act 1974 (the CCA). Consumer Hire agreements do not fall within CCA Sections 8 and 9 but fall within Section 15 of the CCA.

Although not entirely clear, it is likely that a court will accept submissions that consumer hire agreements are either services of a "banking" or "payment nature" especially given the history of this Directive and this clear statement from the EC from July 1999.

The second Banking Directive (89/846/EEC) contains an Annex of Banking Services covered by that Directive. The third one on the list is "Financial Leasing".

This means that all consumer hire agreements are caught from 31 October 2004 under the 2004 Regulations if they are "distance contracts". This means that not only the information requirements in the Regulations must be met, but also that consumer hire agreements will be cancellable for 14 days whereas under the CCA very few are at present.

Regulated v. non-regulated consumer credit agreements

The exemption from the information and cancellation requirements in the 2004 Regulations applies only to regulated consumer credit agreements. Where credit is being granted for more than £25,000-then if the finance agreement is regarded as a "distance contract" then the 2004 Regulations will apply in their entirety.

For regulated CCA agreements, the position is simpler - but only for now. Regulated CCA agreements must continue to give consumers the information set out in the Consumer Credit (Agreements) Regulations 1983 and they will be cancellable only if the conditions in the CCA are met. For now the additional burdens in the new 2004 Regulations will not apply to regulated consumer credit agreements (but they may apply to general insurance products bundled up with the finance agreement and will apply to all consumer hire agreements)but this is likely to change in May 2005 when the next set of Regulations from the DTI come into force to implement the strategy set out in the "Fair, Clear & Competitive" review instituted in December 2003.

If the business in which I am engaged is caught, what do I need to do?

Which lines of business become cancellable which are not cancellable at the moment?

If the business you do is caught by the legislation, you need assistance with implementing the 2004 Regulations across your business in time for the 31 October 2004 implementation date.

Schedule 1 of the 2004 Regulations sets out the information to be provided to the customer prior to the conclusion of the contract, and Schedule 2 provides what information needs to be given in telesales. The information requirements mean that customers have to be told the identity of the supplier,

DISTANCE MARKETING

address, main characteristic of the financial service, taxes, payment arrangements. minimum contract duration, termination rights, choice of law clause, out of court complaint schemes, compensation arrangements and so on.

This will mean that affected businesses will need to review the following for compliance with the 2004 Regulations:

- customer facing agreements
- call centre scripts
- recruitment literature
- fulfilment materials
- point of sale materials
- websites

Affected businesses (especially those transacting consumer hire of any value or consumer credit over (25,000 or selling general insurance) will need to review not only their documentation but also their processes to ensure the 14-day right of cancellation under Regulation 9 is Given. This will need staff training to be able to recognise and act on communications from customers which may not make it clear on the surface that the customer is cancelling.

The notice of cancellation must be given in writing or other durable medium. Leaving it up on a website for a customer to read or

print off is not enough. Life insurance cover has a 30 day cancellation period not 14 days. Cancellation cannot be made over the telephone unless the supplier gives that right. The cancellation right is lost completely if the contract has already been concluded at the customer's request. There is no cancellation right for travel and baggage insurance.

"Staff training will be needed to recognise and act on communications from customers "

Guidance

HM Treasury feels it has done its job now by copying out the two year old Directive from Brussels. It will not be issuing any guidance. As to the DTI, David Hoggett makes it clear that from 31 May 2005, the information requirements in DMFSD will be applying to all consumer credit agreements when the Consumer Credit (Agreements) (Amendment) Regulations 2004 and

the Consumer Credit (Disclosure of Information) Regulations 2004 come into force.

The following businesses will have to comply with the 2004 Regulations in full on 31 October 2004:

- all consumer hire business whatever the value;
- selling IMD excluded general insurance at a distance at the same time as transacting regulated consumer credit or consumer hire business;
- those offering consumer credit of over £25,000;
- selling IMD excluded general insurance products at a distance by subsequent resolicitation.

The following businesses will have to comply with the 2004 Regulations on 31 May 2005:

- consumer credit businesses offering credit of less than (25,000 at a distance;
- consumer credit businesses who cannot be sure that a contract will be concluded at a distance (for example a customer going into a bank branch premises, ringing up to later enquire about a loan and then sending the form back to the branch or contact centre by post).