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May 2025 update:
This letter is historical. See our supervisory correspondence page for more information and current views.

2 December 2020

Dear Board of Directors

In this letter, we:

- Set out our view of the risks Mainstream Consumer Credit Lenders may pose to their consumers or the markets in which they operate. Please consider the degree to which your firm presents such risks and your strategies for mitigating them.
- Outline our expectation of Mainstream Consumer Credit Lenders, including how firms should be mitigating these risks.
- Describe our Supervisory strategy and programme of work to ensure that firms are meeting our expectations, and harms are being remedied.

Changes to how we supervise your firm

In April 2019, we published our revised Approach to Supervision, which sets out why and how we supervise firms and individuals. We group firms with similar business models into at least 1 of approximately 40 portfolios. Your firm has been assigned to the **Mainstream Consumer Credit lenders** (MCCL) portfolio. We send letters like this to all firms in each portfolio.

We are developing a series of supervisory strategies for each portfolio which allow us to effectively monitor all firms and target firms that pose the greatest risk of harm. We are looking for indicators of high-risk firms in each area of harm, and expect to undertake additional testing of these risks with outlier firms. Where we conclude that firms, and/or individuals, are not meeting our expectations, we will act.

Our view of the key drivers of harm for Mainstream Consumer Credit Lenders (MCCL)

To assess how harm could arise, we have analysed the strategies, business models, and drivers of culture (including governance arrangements and purpose) of firms in the MCCL portfolio.

The MCCL portfolio is made up of firms providing Consumer Credit Act regulated unsecured overdrafts, loans or credit cards and contains firms with a range of business models and funding sources. **This letter is relevant to all firms that undertake mainstream lending (active or inactive) including those that are homed in other portfolios.**

There is pressure to deliver financial performance in a challenging competitive and macro-economic environment in many parts of the portfolio. Net interest margins in retail banks are under pressure and the high returns on capital enjoyed historically in consumer credit make it an attractive potential growth business for banks, building societies and specialist lenders alike. Operational and financial pressures have increased due to the impact of coronavirus (Covid-19) and this has the potential to turn into harm for consumers. For all firms, appropriate governance is vital in balancing the needs of their customers and investors or owners in their product and lending decisions.

We see the following ways in which consumers and markets may be harmed:

- Affordability checks firms perform are inadequate, leading to or exacerbating the over-indebtedness of customers.

- Firms fail to establish and implement clear, effective and appropriate policies and procedures for customers in arrears resulting in unfair or inappropriate outcomes for those in financial difficulties.

- Potential unfair treatment of customers as firms embed and respond to our credit card persistent debt regulatory remedies. These are designed to address the problem of credit cards being inappropriately and expensively used for long-term borrowing.

- A potential lack of transparency in the pricing structures and features of consumer credit products which has the potential to lead to adverse customer outcomes. Our work on overdrafts aims to improve transparency in these products, but there still may be information asymmetries in other products.

The above potential harms were identified prior to Covid-19, but awareness of these is even more important in the current environment, as they all have the potential to exacerbate the difficulties customers are facing. To support customers, we introduced measures to provide help with short-term cash flow problems, notably payment deferrals in consumer credit products and interest-free arranged overdrafts up to £500.

With all of these products and the temporary interventions we put in place, customers should be treated fairly as they leave them, as per Principle 6 in our Handbook. As they do, firms should strive towards outcomes that ensure:

- Customers are treated with forbearance and due consideration
- Customers are given sustainable arrangements, taking into account their other debts and essential living costs, which give them reasonable opportunity to repay their debt.
- Customers are not pressurised into repaying their debt within an unreasonably short period of time.
- Customers are protected from escalating debt once they have entered in to a forbearance arrangement with a firm based on what they can afford to pay.

- Firms recognise vulnerability and respond to the particular needs of vulnerable customers. Firms have clear, effective and appropriate policies and procedures for dealing with customers in payment difficulties and for those who the firm understands or reasonably suspects to be vulnerable, and have adequately trained staff to provide their customers with the help they need.
- Customers are allowed time to consider their options and, if necessary, seek debt advice before making a decision on the support they take.
- Customer are referred to debt advice if this is appropriate

We have been, and will continue, to closely monitor the impact of these, as well as the broader impacts of Covid-19 over the coming months.

Our expectations and areas of focus

Affordability: As highlighted in our 2020/2021 Business Plan, we want to deliver outcomes that ensure consumers do not become over indebted by being given credit they cannot afford, and affordable credit is available to smooth consumption. One of our priorities is to identify firms at risk of unaffordable lending and take appropriate action where it is needed.

In our analysis of the portfolio, we observed the following potential inherent drivers of affordability conduct issues:

- ambitious growth targets in unsecured lending

- business models with a focus on speed and ease of approval based on automation, avoiding any reliance or burden on consumers to provide additional information

Business models should be designed to deliver good customer outcomes, and robust affordability assessments are crucial to ensure this. Our updated affordability rules set out that a firm must consider a borrower's ability to make repayments under an agreement, without the repayments having a significant adverse impact on the borrower's financial situation. However, recent testing work has highlighted:

- high proportions of recently originated accounts in arrears, which may be an indication of unaffordable lending

- inadequate creditworthiness assessments, including a lack of rigour for higher risk customers

- an over-reliance on credit risk modelling which seeks to use data to predict whether repayments will be made rather than whether the customer can afford to make the repayments (affordability risk)

- a reliance on Credit Reference Agency and other statistical or modelled data or tools within affordability assessments, without a full understanding of the data and its limitations

We expect firms to consider their business model and their customer base and conduct reasonable assessments of the affordability risk posed to customers by the credit they are applying for. This may involve taking a more intensive approach for higher risk customer segments and lending. We are continuing work to test firms' approach to assessing affordability and will intervene where we see lending that is not responsible.

Treatment of customers in arrears: We have identified examples of inadequate treatment of these customers. Specifically, some firms have failed to treat customers in default or in arrears with forbearance and due consideration. We are concerned about how firms maintain appropriate oversight where they have outsourced arrears management activities such as debt collection and/or debt administration.

The current (and anticipated) changes in the macroeconomic environment, notably increased unemployment, may mean more people face financial difficulties over the coming months and consequently fall into arrears. We introduced payment deferrals to help customers who are facing short-term cash flow problems. For some customers, however, these short-term financial difficulties will end up being longer-term and they will need ongoing forbearance so it is even more important that firms assure themselves their arrears handling operations are fit for purpose.

We have now confirmed measures to ensure firms provide tailored support for users of certain consumer credit and overdraft products who continue to face payment difficulties due to coronavirus.

Firms should ensure they have clear, effective policies and procedures for customers who fall into arrears. Additionally, they should ensure the appropriate skills and resources are in place to deliver these – both quantitatively and qualitatively – and they are treating customers fairly. This applies in equal measure to customers who had financial difficulties before Covid-19, which may have been exacerbated during this time.

For outsourced arrears processes, we remind firms they remain responsible for their regulatory obligations as per SYSC 8.1.6R and should have appropriate oversight and governance for activities the outsourced firm carries out on its behalf. There is further guidance around SYSC 8.1.6R in CONC 7.13.8G – CONC 7.13.13R. We will continue to monitor and review firms' practices through ongoing supervisory activity and are prepared to take action against firms where we find evidence of poor practice.

Embedding of regulatory changes: As part of the Credit Card Market Study (CCMS), we developed remedies, notably to tackle persistent debt and provide for earlier intervention. In the case of persistent debt, we made rules which require firms to contact customers falling within our definition of persistent debt and encourage them to make faster repayments. For customers who reach 2 consecutive periods of persistent debt, firms must take reasonable steps to assist them in repaying their outstanding balance within a reasonable period. Where a customer cannot afford to do so, firms must offer forbearance to help the customer to repay the outstanding balance in a sustainable way. This may include reducing, waiving or cancelling any interest, fees or charges.

Given the relative flexibility in how firms may comply with our persistent debt rules, the impact the remedies are having is an important focus for us. Our Dear CEO letter tells firms to review their approach to borrowers who are in persistent debt.

We expect that firms not only meet the letter of our rules, but also consider the requirement to treat customers fairly when implementing them. We have completed a multi-firm piece of work around the persistent debt remedies and will review the effectiveness of these remedies after they have been operating long enough for us to assess consumer outcomes.

More recently, we gave customers extra time to respond to the 36-month communication, extended until 1 October 2020. We also suspended the remedies for customers who have taken up a payment deferral and are monitoring this as part of our broader supervision of payment deferrals.

Transparency of pricing and features: We expect firms to assure themselves that disclosures and adequate explanations across all distribution channels means their customers can make informed decisions when considering a consumer credit product.

In credit cards, we reviewed the frequency of, and reasons behind, the withdrawal of introductory promotional rates in 0% balance transfers. For most of the firms in the sample, a number of customers had incurred interest on purchases they made during the statement period and then repaid in full, before the payment due date. We are concerned that some customers may not understand that interest will be charged on new purchases from the day of the transaction, rather than benefiting from an interest-free period until the next payment date.

We urge firms to ensure they make clear to consumers all of the features of a credit card, including balance transfer cards.

In June 2019, we introduced rules to reform the overdraft market, which came into force between November 2019 and April 2020. We found that fees paid for unarranged overdrafts were regularly 10 times as high as fees for payday loans. These new rules address both how much the most vulnerable were being charged for unarranged overdrafts, and the level of fees and charges that many arranged overdraft customers were paying on top of interest rates. Some firms were charging some of the most vulnerable customers an effective interest rate of more than 80% a year on their arranged overdraft. For further details of our work on overdrafts see our website.

Given the ongoing coronavirus situation, we introduced specific measures in April 2020 to help consumers financially affected by coronavirus. This includes firms making sure that all overdraft customers will be no worse off when compared to the prices they were charged before the new overdraft rules, as well as interest-free overdrafts up to £500.

In all consumer credit products, we expect firms to proactively monitor customer outcomes across their products to look at whether borrowers are using them in a way that suggests they understand them. Where there is evidence they are not, firms should act where they identify harm occurring from a lack of transparency. Where we identify harm, we will intervene.

Brexit

The UK left the EU with a Withdrawal Agreement on 31 January 2020 and entered a transition period, during which it will negotiate its future relationship with the EU. The transition period is due to operate until 31 December 2020. During this time EU law will continue to apply in the UK and passporting will continue. As matters develop, you will need to consider how the end of the transition period will affect you and your customers, and what action you may need to take to be ready for 1 January 2021. For information on Brexit, including what the transition period means, visit our website.

Next steps

We expect you to reflect on the issues highlighted in this letter to challenge how your firm operates to minimise the consumer and market harm it may cause.

As part of our supervision of firms, we will engage with some Mainstream Consumer Credit Lenders to discuss their business models, strategies, and cultures. Our work plan will also employ appropriate supervisory tools to test, and where necessary mitigate, the potential areas of harm. Our supervisory work is supported by wider engagement and communication strategies to make clear our expectations of firms, proactively identify harms arising and ensure appropriate mitigation is put in place. We will act where we find poor customer outcomes from a failure to follow our rules.

If you have any questions and you are a fixed portfolio firm please contact your Supervisor in the first instance. If you are not, please contact your normal supervisory contact on 0300 500 0597. This is the primary point of contact for your firm's day-to-day interactions with the FCA, and further details of how we can be reached are on our website at https://www.fca.org.uk/contact.

We recognise that there may be circumstances in which your firm faces urgent issues of strategic importance. In such significant circumstance, please contact me on 0207 066 0042, or at Caroline.Gardner@fca.org.uk. If I am not available, then please contact one of my Managers, Kate Brooks, on 0207 066 1750 or at Kathryn.Brooks@fca.org.uk.

Yours sincerely

Caroline Gardner
Head of Department
Supervision – Retail & Authorisations Division