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

6 March 2019

Re: Portfolio Strategy Letter to firms providing high cost lending products

Dear CEO

This letter sets out our view of the key risks that High Cost Lenders pose to their consumers or the markets they operate in. You should consider the degree to which your firm presents such risks and your strategies for mitigating them.

Our High Cost Lenders supervision strategy covers the period to January 2021. This strategy includes work to identify, diagnose and remedy the harms in this portfolio. It also evaluates the impact of our interventions. We will write to you again after January 2021 to give you our updated view of the key risks posed by firms in this portfolio and our updated plans to supervise them.

This follows our new approach to supervision, implemented in 2018. As part of this, we have put all the firms we supervise into different ‘portfolios’. Each portfolio is made up of firms with broadly similar business models. We have allocated your firm to the High Cost Lenders portfolio. We will regularly analyse each portfolio and give the firms within it the results of our analysis.

Who this letter applies to

This letter applies to firms providing the following products:

- guarantor loans
- high-cost short-term credit (HCSTC)
- high-cost unsecured loans aimed at sub-prime customers
- home-collected credit (HCC)
- income smoothing products
- logbook loans
- pawnbroking
- rent-to-own (RTO)

It also applies to community development finance institutions (CDFIs).

Please note that firms under our supervisory strategy for high cost lenders only provide some of the products that our recent high-cost credit review (HCCR) covers. We will cover other products in the HCCR, such as overdrafts, in further Portfolio Strategy letters to firms in the relevant portfolios.

Firms in this portfolio vary significantly in size and have a wide variety of specific business models and products. However, customers who use high cost credit products tend to share some key characteristics – for example, they tend to have poor credit histories and low financial resilience. Many of them are also likely to be vulnerable. Given these characteristics, lack of appropriate affordability checks and poor treatment of customers in default or arrears creates a risk of considerable harm. Firms are reminded of their obligations to treat customers fairly and appropriately. They should also ensure that they take an appropriate approach to creditworthiness assessment and treat customers in default, or in arrears, with forbearance and due consideration.

Poor firm culture can be a key driver of harm, an example of this is where firms have high-risk financial incentives and/or performance management practices, coupled with inadequate or ineffective systems and controls, that may lead to poor consumer outcomes. Firms are reminded of their obligations to identify and manage any risks arising from their remuneration or performance management practices. In March 2018 we published a Policy Statement issuing new rules and guidance regarding staff incentives in consumer credit, we expect firms to comply with our new rules.

While not all of the findings of our letter may apply to your firm, we have seen a number of specific causes of harm across the firms in this portfolio. We therefore encourage you to read and reflect on the entire letter. If we have contact with your firm in the future, we will expect you to be able to explain what you did in response to this letter.

Our view of the key causes of harm

To assess how firms in the High Cost Lenders portfolio could cause harm, we analysed their strategies and business models. We considered a wide range of information and data, including firms' regulatory histories, the number and nature of complaints, and findings from the HCCR. We also carried out diagnostic work on guarantor lenders, which involved issuing a data request to firms in October 2018.

Following our analysis, we see two key ways that consumers may be harmed across the High Cost Lenders portfolio:

- a high volume of relending, which may be symptomatic of unsustainable lending patterns
- firms' affordability checks may be insufficient, leading to loans that customers may not be able to afford

We also see an additional potential harm from guarantor lending:

- the proportion of loan repayments that guarantors make has risen considerably, which could indicate that affordability on the part of the borrowers is falling

Our areas of focus for all firms

We will prioritise our supervisory work in the following areas:

Relending: We have seen a high volume of relending across all credit products in the portfolio. We aim to carry out diagnostic work across the portfolio so that we can better understand the motivation for, and impact of, relending on both consumers and firms. This work will examine aspects of relending such as customers' borrowing journeys, firms' marketing strategies for offering additional credit and the costs of relending for consumers. We want to understand what harm, if any, relending may cause consumers.

As part of this work, we will proactively engage with home-collected credit firms to ensure they understand our expectations. We will also discuss any changes to their processes as a result of the new rules and guidance on relending which we issued in our December 2018 Policy Statement on high-cost credit.

Affordability: We recognise that there is an inherent challenge for these firms in assessing affordability for both new loans and repeat borrowing. High-cost credit customers' finances are often squeezed and they may have poor credit histories and low financial resilience. Nevertheless, firms must ensure that they are complying with all our affordability requirements. We gave an outline of these requirements in the Dear CEO letter we sent to HCSTC firms in October 2018. While this letter was aimed at HCSTC firms, the main principles are relevant to all firms in this portfolio.

In July 2018, we published a Policy Statement clarifying our expectations on creditworthiness, by issuing new rules and guidance which came into effect on 1 November 2018. We expect you to comply with our new rules. Our ongoing supervisory work on affordability with firms will continue to drive improvements in this area. As with all our rules, we will take the necessary action where we identify non-compliance.

Complaints: We know that there have been increasing numbers of complaints about many of the products in this portfolio. Firms should ensure that they are handling complaints appropriately. We expect firms to fulfil all relevant obligations, including analysing the root causes of complaints and taking into account the Financial Ombudsman Service's relevant decisions. We gave further detail about what we expect from firms' complaint-handling procedures in the Dear CEO letter we issued to HCSTC firms in October 2018. This is equally relevant to all firms in the portfolio.

Buying/Selling existing loan portfolios: We know that some firms may be considering selling loan portfolios. We expect any firm considering buying or selling an existing loan portfolio to be mindful of their obligations to treat customers fairly and, where appropriate, to notify us of their intentions at an early stage. As with all our rules, we will take the necessary action where we identify non-compliance

Changes to business model: We have seen a change in the business models of some of the firms in this portfolio, as they expand their services to offer new products. Firms should be aware that they are required to hold the correct permission(s) for all of their regulated activities. Firms should inform us at any early stage, in these circumstances, to comply with their obligations under Principle 11.

Compliance with new rules and guidance: We have issued various new rules and guidance over the course of our HCCR. We expect firms to comply with our new rules as they come into force. We will monitor compliance and evaluate how well firms are implementing our rules and

guidance through proactive engagement, ongoing supervision and by monitoring regulatory returns and complaints.

Additional focus for firms providing guarantor lending

As well as the areas of focus above, we will also prioritise our supervisory work with firms that provide guarantor loans in the following area:

Payments made by guarantor: Our diagnostic work on guarantor lending showed that many guarantors make at least one repayment and the proportion of guarantors making payments is growing. We want to understand the root causes for this increase, and whether firms are conducting adequate affordability assessments. We are also concerned that guarantors may not fully understand how likely it is that they will be called upon to make a payment. So, as well as our broad portfolio-wide work on relending, we will start a piece of complementary work on guarantor lending. This will establish whether potential guarantors have enough information to understand the likelihood and implications of the guarantee being enforced.

Next steps

If you have any questions please contact your normal supervisory contact on 0300 500 0597. They are your main point of contact for your firm's day-to-day interactions with the FCA. Further details of how we can be reached are available on our website.

However, we know there may be occasions when your firm faces urgent issues of strategic importance. In such significant circumstances, please contact me on 020 7066 5900. If I am not available, then please contact my team's manager, Alison Russell, on 020 7066 7942.

Yours sincerely

Roma Pearson
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Supervision Retail & Authorisations Division