Financial Conduct Authority

Arrears and Forbearance in High-Cost Short-Term Credit

March 2015

Thematic Review

TR15/3

Contents

1. Executive summary

1.1 Overview

We took over regulatory responsibility for consumer credit in April 2014 and this is our first thematic review into the consumer credit market. As part of our supervisory role, we undertake thematic reviews to assess a current or emerging risk relating to an issue or product across a number of firms within a sector or market.

The purpose of this review is to examine how high-cost short-term credit (HCSTC) firms deal with customers in arrears and whether they treat their customers fairly. The review looked at a range of firms, including both large and small HCSTC lenders and both online and high street lenders. This report summarises our findings and highlights the actions we have taken to secure improvements for customers.

1.2 The standards that apply to HCSTC firms

The majority of the standards that we expect firms to meet when dealing with customers who are struggling to repay are not new. They have existed for a number of years in the Consumer Credit Act 1974 (as amended) (CCA) and Office of Fair Trading (OFT) guidance. Many of those standards were carried across, and in addition to new rules made, were translated in April 2014 into the FCA Handbook within the Consumer Credit Sourcebook, known as CONC.

In addition, the introduction of the FCA regime in April 2014 introduced new high level standards for firms, contained in the FCA Handbook. These include the 11 Principles for Businesses (PRIN) and the threshold conditions (COND). Consumer credit firms must also comply with our general provisions (GEN) and rules on senior management arrangements, systems and controls (SYSC). As well as imposing obligations to communicate transparently and treat customers fairly, our rules also require businesses to be properly run, with systems and controls that are fit for purpose, and we expect senior management to be accountable for what happens in their firms.

During the course of the thematic review, from July 2014, HCSTC firms were required to comply with new CONC rules limiting the number of loan rollovers to two and restricting to two the number of times a firm can seek repayment using a continuous payment authority (CPA). These rules were designed to tackle the harm being caused by these practices to consumers across the HCSTC sector and to create stronger incentives for lenders to make good lending decisions.

1.3 What we found

We launched the thematic review in April 2014 and gathered our evidence over the course of the year. It was a period of significant change for firms and our findings represent a series of snapshots in time of evolving firm practice and customer experiences. While our evidence gathering focused on the post April 2014 period, we inevitably found evidence of firms' practices from before we began regulating the market.

Key findings

In a number of cases we found evidence of serious non-compliance and unfair practices.

- These include firms which had engaged in misleading practices to obtain monies from customers in arrears.
- We have intervened swiftly to prevent ongoing risk of harm to consumers and to secure commitments from firms to put things right. We acted to ensure that past practices were investigated, that systems and controls were strengthened to mitigate the risk of these happening again, and that firms agree to pay redress to customers.
- In some cases our investigations are still ongoing. The information from our further investigative work will feed into our authorisations process and further action will be taken as required.

Most firms were implementing significant changes, but none of the firms we reviewed were sufficiently prepared for FCA regulation and they had not yet adapted their businesses to meet the required standard.

- All firms were implementing significant improvements and a number were making good progress towards a collections culture focused on treating customers fairly.
- A number of firms had implemented revised policies and procedures, retrained their staff on how to identify vulnerable customers, started to monitor compliance more effectively, and revised their staff incentives.
- However, the level of reform required to bring their policies, procedures processes and IT systems up to scratch was substantial, and some firms were struggling with the pace of change needed. They all – to varying degrees - lacked the necessary oversight, risk management and compliance monitoring. This had led to poor outcomes for many customers. In some cases, firms had only very recently documented their policies and procedures.
- Some firms had seriously underestimated the volume, range and complexity of the arrears cases they experienced, which meant they were short-staffed and agents were inadequately trained.
- All firms had undergone changes to their senior management just prior to or shortly after the FCA took over regulation or as a direct result of discoveries through our review.
- In some cases we have secured commitments from firms to put in place interim measures – such as ceasing certain activities or engaging outside expertise – to ensure that there is no ongoing risk to their customers while they are implementing these improvements.

Firms had experienced systems failings that had led to customer detriment. Many of these were only dealt with due to our review and firms were too often failing to consider the impact on their customers.

- All firms had experienced failings in their systems that had resulted in errors in account balances, the erroneous application of fees and charges, or the taking of payments at the wrong time, including duplicate payments.

- We have worked with firms to identify and rectify these errors and to tackle the root causes in their systems to mitigate the risk of these happening again.

- There were other cases of systems errors and process failings that had led to customers being inconvenienced, frustrated or treated unfairly. For example, some firms failed to place holds on customers' accounts when promised, which meant that they made collections calls to those customers in breach of their own policies.

Firms were generally not good at recognising customers with financial difficulties or those who were vulnerable,[1] resulting in poor outcomes.

- Firms were not effectively directing these customers to free and independent advice where appropriate.

- Firms frequently failed to consider, or ignored, relevant information that they already held on customers including their borrowing and repayment history.

- Poor record keeping and delays in opening correspondence also meant that firms were not taking into account crucial information about their customers, and customers were having to repeat themselves.

- Firms were also missing relevant triggers or indicators presented by customers and generally did not have an open dialogue with their customers about their circumstances and forbearance options. Staff had a low awareness of the factors that might affect a customer's ability to meet repayments.

- This meant that in some cases they failed to offer appropriate forbearance that took account of customers' individual circumstances. For example, we saw customers agreeing to repayment plans that were obviously unsustainable and subsequently failed.

- Sometimes this was exacerbated by the fact that the firm's own behaviour had contributed to the customer's situation, for example where the customer had been encouraged to roll over their loan an excessive number of times, where customers had been treated unfairly by systems errors, or where customers had experienced pressure as a result of communications from firms.

Whilst some firms did explore forbearance options and sustainable repayment arrangements with customers, others pushed for immediate or unsustainable repayment.

- Some firms rigidly utilised fixed-term repayment arrangements, requiring customers to pay over relatively short time frames and which did not take into account the customer's individual circumstances and ability to repay sustainably.

1 The FCA has published an occasional paper on consumer vulnerability to stimulate interest and debate around vulnerability and to provide practical help and resources to firms. Occasional Paper No.8 - Consumer Vulnerability, 23 February 2015 www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-8

- Some firms did not recognise or acknowledge that certain customers were vulnerable or in financial difficulties and were restricting their access to forbearance.

Firms' communications with their customers were sometimes unclear or misleading.

- Some firms implied that customers' accounts would be subject to legal or other action, including escalation to a third party debt collector, when this was not the case.

- Some firms provided customers with misleading information about the consequences of their actions, or inaction, for their credit file.

Default and arrears fees and charges had reduced in most of the firms we looked at.

- We visited firms before the HCSTC price cap came into effect. However, in most firms there had been a reduction in their default and arrears fees and charges during the period of our review. Typically firms had reduced the number of days they would charge customers interest while in default, rationalised the number of fees they charged to customers in default and reduced the level of their default fees.

Our findings are detailed in Chapter 3.

1.4 Next steps

We have given feedback to each of the firms in our sample about the good and poor arrears and forbearance practices we observed in their businesses. In response to the feedback, firms have made improvements to their systems and controls, and how they treat their customers.

In a number of cases we have investigated where we found unfair practices. We have taken swift action to stop poor practice and mitigate risk, and we have secured voluntary commitments to provide redress to customers who have suffered harm as a result of unfair treatment. In some cases our investigations are still ongoing.

In January 2015, we contacted all HCSTC firms to remind them that if they want to continue to conduct regulated consumer credit activities, they must demonstrate to us they are complying with the rules and treating customers fairly, including when customers struggle to repay a loan.[2]

Most firms that held an interim permission for HCSTC and wish to continue engaging in regulated consumer credit activity must have submitted applications for authorisation by 28 February 2015. The authorisations process will scrutinise in-depth all lenders seeking the HCSTC permission and those that cannot demonstrate that they meet the threshold conditions will be refused.

All HCSTC firms should take careful note of the findings of this review and consider what improvements they may need to make to their business practices in light of it, including whether:

- their systems are fit for purpose

- they have established and implemented clear, effective and appropriate policies and procedures

2 Dear CEO letter - The FCA's expectations of high-cost short-term lenders, sent on 21 January 2015. www.fca.org.uk/your-fca/documents/dear-ceo-letters/dear-ceo-letter-hcstc-firms

- their staff are adequately trained
- they need to take steps to provide redress to customers affected by any past unfair treatment of customers

1.5 Who should read this report?

This report will interest firms operating, or considering operating, in the HCSTC market and trade bodies representing these firms. It will interest firms and other bodies that provide debt advice and solutions to consumers who use HCSTC. It will also interest the organisations that represent consumer interests and individual consumers.

2. Background and approach

2.1 Introduction

When we took over responsibility for regulating consumer credit in April 2014 we said that tackling poor practice in the HCSTC market was a key priority for the first year of the new regime.

Our Business Plan for 2014/15 set out a number of commitments to improve outcomes for customers in this market, focusing on tackling harm to the customers most at risk – those at risk of taking out unaffordable loans and those who are already struggling to repay existing credit. We have taken a number of actions in the HCSTC sector to address irresponsible lending. For example, we have introduced a price cap on HCSTC loans, secured commitments from individual firms to improve the way they assess affordability and worked with the industry to promote real-time data sharing. We have also separately engaged with a number of individual HCSTC firms to improve the way they treat customers. These interventions are set out later in this chapter.

This thematic review focused on the experience of customers who are struggling to meet their repayments. The review, which launched in April 2014, scrutinised how a sample of firms across the HCSTC market dealt with customers in arrears, what forbearance they offered and how they collected outstanding debts. Our aim is to improve standards in arrears management and forbearance across the sector. This report summarises our findings and highlights the actions we have taken to secure improvements for customers.

2.2 Context for the review

The HCSTC market

The HCSTC market grew rapidly from the middle of the last decade as more and more consumers turned to this type of credit to help manage their finances, reaching a peak in 2012/13. According to our estimates, in 2013, 1.6 million customers took out around 10 million loans worth £2.5 billion. Since then the market has contracted as firms have adopted tighter lending criteria in response to FCA regulation. We estimate that between September 2013 and August 2014 there was a 40% reduction in HCSTC lending by volume and a 35% reduction by value.

The Competition and Markets Authority (CMA) found that 64% of payday loans issued in 2012 were repaid in full, either early or on time[3], meaning that over one third of loans were not repaid on time. Six out of ten complaints to the OFT about payday lending were about how

3 Competition and Markets Authority – Payday lending market investigation Final Report (24 February 2015) www.gov.uk/cma-cases/payday-lending-market-investigation

loans were collected.[4] Research we commissioned to help us introduce new rules to cap the price of HCSTC loans found that many HCSTC customers struggle to make ends meet day to day and that their situation often worsens after getting a HCSTC loan.[5]

Information and evidence from other bodies, including consumer groups and organisations providing debt advice, and complaints statistics published by the Financial Ombudsman Service (the ombudsman service), also shows that consumers continue to experience poor outcomes in this sector. The ombudsman service conducted an analysis of a sample of complaints that were opened and closed in 2013/14 and found that issues relating to customers in arrears and default featured prominently, such as lenders refusing to agree a repayment plan, aggressively chasing debts, poor administration and high default fees. Worryingly, these issues were significantly more likely to be prevalent where the customer was vulnerable.[6]

Relevant rules and guidance

Firms must be authorised by us, or have interim permission, to offer consumer credit. Firms that held an OFT licence and registered for interim permission can continue to carry out those consumer credit activities covered by their interim permission up to the end of their designated application period, by when they must have applied for authorisation or ceased all regulated activity. We invited firms in those sectors we deemed had the greatest potential for consumer detriment – including HCSTC – to apply for authorisation first. If a firm held an OFT licence but did not register for interim permission, it cannot lawfully conduct consumer credit activities without first obtaining authorisation from the FCA.

Firms carrying out regulated consumer credit activities must follow certain rules about how they manage their businesses and treat their customers. These include rules made by us, which are in our Handbook, and the requirements of the CCA and secondary legislation.

Clear standards in relation to the treatment of customers in arrears or financial difficulties have existed for some time in the form of provisions of the CCA and the OFT's Debt Collection Guidance and Irresponsible Lending Guidance. When we took over regulation of consumer credit, many of those standards were carried across. In addition, new rules were made and are reflected in our Handbook as the Consumer Credit Sourcebook (CONC), Chapter 7 of which deals with arrears, default and recovery. Although many of the standards for firms are not new, they have been more rigorously enforced by the FCA using our greater powers and resources.

During the course of our review, on 1 July 2014, new CONC rules came into effect that had a significant impact on HCSTC firms and on the experience of their customers. These rules limit (to two) the number of times HCSTC firms can attempt to take payment using a continuous payment authority (CPA) and prevent the use of CPAs to take partial payments, as well as imposing a maximum of two rollovers or refinances per loan. We introduced these rules because some firms were using CPA as a debt collection method and because of our concerns that loans which are repeatedly rolled over can lead to unsustainable debt burden for consumers.

On 1 April 2014, consumer credit firms also became subject to the FCA Handbook's high level standards. Firms must abide by the 11 Principles for Businesses (PRIN). They must also meet, on an ongoing basis, the threshold conditions for authorised firms (COND). And they must comply with the rulebooks relating to senior management arrangements, systems and controls (SYSC)

4 OFT analysis of customer complaints received November 2012-November 2013.

5 FCA Consultation paper CP14/10 – 'Our research broadly confirmed…that, when they apply for HCSTC loans, many customers are in a difficult, and deteriorating, financial situation.' www.fca.org.uk/news/cp14-10-proposals-for-a-price-cap-on-high-cost-short-term-credit

6 Payday lending: pieces of the picture, Financial Ombudsman Service, August 2014 www.financial-ombudsman.org.uk/publications/policy-statements/payday_lending_report.pdf

and complaints handling (DISP). These requirements reflect the standards that we expect from all firms that have the interests of its customers at the heart of its business.

Among other things, these requirements include obligations to:

- pay due regard to the interests of customers and treat them fairly
- communicate with customers in a way that is fair, clear and not misleading
- have a business model that operates in line with customers' interests
- ensure that those who manage the firm have adequate skills and experience and act with integrity
- put in place systems and controls to manage risk effectively
- be adequately resourced and employ staff with the necessary skills, knowledge and expertise

When customers are in default or in arrears difficulties, lenders are required to treat them with forbearance and due consideration, which should include considering whether it is relevant in the circumstances to:

- suspend, reduce or waive fees and interest
- allow customers to defer repayment
- accept token payments for a reasonable period of time to allow them to recover from an income shock if making a larger repayment would mean that the customer would not be able to meet priority debts or living expenses

Firms should allow customers in default or in arrears difficulties reasonable time and opportunity to repay their debts and should not refuse to negotiate with a customer or to accept reasonable offers from customers or their representatives. Where appropriate, firms should direct customers in arrears and default to a source of free and independent debt advice.

Firms must have clear and effective policies and procedures for the fair and appropriate treatment of customers who they understand or reasonably suspect to be particularly vulnerable and they must suspend action to recover a debt where they have reason to believe that the customer lacks the mental capacity to make decisions or engage in the process at that time. To stimulate interest and debate around vulnerability and to provide practical help and resources to firms, the FCA has published an occasional paper on Consumer Vulnerability.[7]

Firms must not pressurise or threaten customers to get them to pay more than they can reasonably afford or take disproportionate action to recover the debt. Communications to customers cannot be misleading or threatening, or seek to publicly embarrass the customer. Firms must not continue to pursue a debt where the amount owing or the identity of the debtor is disputed.

7 Occasional Paper No.8 - Consumer Vulnerability, 23 February 2015 www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-8

Our rules and guidance also place clear expectations on firms to ensure they have appropriate processes in place to identify when things go wrong for their customers and to cooperate openly and constructively with the FCA.

The impact of regulatory change

None of the firms we examined were fully prepared for FCA regulation on 1 April 2014 in terms of their approach to arrears and default. At the outset of the review, firms' collections models were heavily reliant on making multiple CPA attempts, and for a number of firms our evidence suggests that rollovers and relending were customary practice and had often been used in lieu of forbearance where a customer was experiencing financial difficulties.

When we began the review in April, most firms were actively reviewing their approach to arrears and default and the introduction of new rules effective from July 2014 led to further changes in firms' collection practices. This included firms placing greater reliance on more 'traditional' collections methods that focused on seeking repayment by attempting contact with customers on the phone or via letters, emails and SMS text messages. Firms also invested in controls designed to safeguard against breaching the limits on CPA attempts and rollovers, including developing IT systems and re-training staff.

As well as making these specific changes, all but one of the firms in our sample were, at the time we visited them, undertaking a wider review of their existing practices with a view to obtaining full authorisation from the FCA. In a number of cases, firms were demonstrating real commitment to change and were making significant investments to achieve this. However, in all of the firms we looked at this was long overdue. The extent of the improvements they needed to implement to become fully compliant were far-reaching and in many cases involved an overhaul of firm practices, systems development, changes to key personnel and significant up-skilling of staff. A number of firms had engaged external advisers to support this process.

In a number of cases we were forced to intervene swiftly to prevent ongoing risk of harm to customers as a result of serious non-compliant and unfair practices. For example, where we had serious concerns with the content of some debt collection communications or where firms had used misleading practices to obtain monies to repay outstanding debts. In some cases, such practices were taking place around the time we visited firms and in others they had largely stopped just prior to FCA taking over regulation in April 2014. We acted to ensure that these practices were investigated, that systems and controls were strengthened, and that firms agree to pay redress to customers. In some cases our investigations are ongoing. The information from our further investigative work will feed into the authorisations process and further action will be taken as required.

In relation to sanctions for poor practices by consumer credit firms prior to April 2014, the broad position is that the disciplinary powers of the FCA are equivalent to the powers that the OFT had at the time that the conduct took place. However, past conduct before 1 April 2014 may have relevance for our supervision of a firm going forwards and for our decision whether to approve a firm's application for authorisation.

We have also separately engaged with a number of HCSTC firms to improve the way they treat customers, both in relation to arrears handling and more widely, for example, in relation to unaffordable lending or non-compliant financial promotions. These interventions have come about through a range of channels. For example, some have been in response to customer complaints or other intelligence, including information reported to our contact centre, some have resulted from investigations inherited from the OFT, some have arisen in the course of other proactive supervision activities by the FCA, and some issues have been brought to our attention by firms themselves.

Our interventions to date in relation to HCSTC firms include:

- 100 cases opened against HCSTC firms for unfair, unclear or misleading financial promotions
- In nine cases, firms have entered into a formal agreement, known as a voluntary requirement (VREQ), which commits them to take action to remedy specific failings, such as:
  - unfair and aggressive debt collection practices
  - inadequate compliance monitoring and oversight
  - inadequate affordability assessments
  - unfair or excessive charges
  - inappropriate and excessive use of rollovers
  - misuse of customer bank card details
  - systems errors resulting in harm to customers

  These actions include, for example, implementing immediate measures to prevent ongoing harm to customers, such as the suspension of certain activities pending improvements to firms' practices, and paying any redress due to customers who have been unfairly treated.
- We have initiated five skilled persons reviews,[8] undertaken by third parties at the firms' own expense, to review firms' practices and oversee redress schemes.
- To date, we have secured a number of commitments to pay significant redress. In a number of cases we are in ongoing discussions with firms to determine the value and scale of any redress due.

2.3 Methodology

We gathered intelligence and reviewed the available data, including analysis by the CMA, payday loan survey data from Citizens Advice and complaints to the ombudsman service. We held exploratory meetings with firms and met with consumer organisations and trade bodies. This helped us to identify the key issues to explore and which firms to include in our main sample.

Our sample of firms represented a spread of large and smaller lenders, online and high-street businesses. This enabled us to review a range of practices from across the market. All of the firms in the sample offered, at the time we started the review, a single payment loan product with a typical repayment term of around a month, and this product was the primary focus of

8 A Skilled Person Review is one of the regulatory tools the FCA can employ under the Financial Services and Markets Act 2000, as amended (FSMA). We use these powers to obtain an independent view of aspects of a firm's activities that for example cause us concern or where we require further analysis.

our review. However, a number of firms in the sample also offered other products including HCSTC instalment products and longer term instalment loans. All the firms were idiosyncratic, with different business models and different corporate structures. All had a separate collections function but these varied in size and structure. A number of firms in the sample outsourced elements of their business to third party providers. The total market share by revenue of the firms in our sample was around 60%, based on 2013 data.

We requested information from firms about their products, policies, procedures, systems and controls. Throughout summer 2014 we carried out visits where we assessed firms' systems and processes and interviewed or observed in total over 100 senior managers and staff. We observed how collections agents and complaints handlers engaged with customers and listened in to live calls and call recordings. We also observed staff carrying out compliance and quality assurance checks on frontline agents.

We obtained data from firms that enabled us to identify and request full case files for samples of customers in arrears so that we could take a deeper look at their experience. We reviewed these customer files, which contained loan agreements, correspondence, case notes and recordings of telephone calls, to determine whether the firms had complied with the relevant legislation, rules and guidance, as well as with their own internal policies and procedures.

We have given feedback to each of the firms within our sample about the good and poor arrears and forbearance practices we observed within their businesses. In a number of cases we have engaged with firms to investigate further where we found unfair practices.

3. Our detailed findings

3.1 Overview

Overall, we found that firms were not sufficiently well managed. Poor administration, inadequate systems and a lack of effective monitoring and oversight had contributed to unfair treatment of customers. We found a number of cases where customers' balances were inaccurate, they had been overcharged, or payments were taken in error.

At the time that we visited them, firms were not consistently complying with their obligations to treat customers in arrears and default with forbearance and due consideration. Often this was due to a failure to recognise that customers were in financial difficulties or were vulnerable, even though the firm should reasonably have been aware of this. Some firms also placed unreasonable obstacles in the way of customers seeking forbearance. Firms did not always give the customer reasonable time and opportunity to pay, sometimes pressing for repayment plans that were unlikely to be sustainable in light of the customer's circumstances. Linked to this, firms had sent misleading or unclear communications to customers.

In a number of firms we found evidence of serious non-compliance and unfair practices. These included the content of some debt collection communications, and misleading practices used to obtain monies from customers in arrears. In some cases, such practices were taking place around the time we visited firms and in others they had largely stopped just prior to FCA taking over regulation in April 2014. We have intervened swiftly to prevent ongoing risk of harm to consumers and to secure commitments from firms to put things right. We acted to ensure that past practices were investigated, that systems and controls were strengthened to mitigate the risk of these happening again, and that firms agree to pay redress to customers.

In some cases our investigations are still ongoing. The information from our further investigative work will feed into the authorisations process and further action will be taken as required.

On the positive side, most firms we saw had significantly reduced the amount of default fees and interest that they charged customers in arrears and default. Firms were implementing significant improvements and a number were making good progress towards a collections culture focused on treating customers fairly. For example, these firms had implemented revised policies and procedures, started to monitor compliance more effectively, revised their staff incentive structures so that staff were no longer rewarded solely for how much cash they collected, and were retraining their staff on how to identify vulnerable customers. This was leading to changes in the experience of customers in arrears and default, with lenders more willing to seek to understand a customer's situation and offer them forbearance and due consideration in light of their individual circumstances.

3.2 Attitudes to regulation

The firms we visited were in varying states of change, but in April 2014 none had fully prepared and adapted their business to meet the standards expected by the FCA.

Firms had varying attitudes to FCA regulation. Some engaged openly and proactively and notified us of specific conduct failings. Others appeared to have seriously engaged with the need to raise standards only in response to our direct intervention and were reluctant to disclose the existence of compliance issues.

A number of the more proactive firms had sought the services of external consultants to advise on the review of their existing practices. Senior management at these firms had started to move away from purely cash-collections-focused cultures and appeared to be encouraging staff to pay more regard to the interests of customers and treat them fairly. In some firms this was being demonstrated by programmes of remediation and redress for past unfair treatment. However, these developments were relatively recent. In most cases, even where senior management had committed to improvements, we frequently found weaknesses in firms' control environments preventing changes from being effectively embedded and monitored. We found that policies and procedures, and the monitoring of these, required further development and staff skills and behaviour needed to improve. We intend to assess the results of changes that firms have committed to through the authorisations process.

Some firms had taken minimal action to start complying with our rules and lacked the necessary management competence and resources to adapt to our expectations. Many changes were largely driven by what we uncovered in our review and our intervention has been required to secure firm commitments to implement them in a timely manner. Where necessary, we have taken immediate steps to ensure that these firms do not pose ongoing risks to their customers. In some cases our investigations are still ongoing. All firms seeking consumer credit permissions must demonstrate that they satisfy, and will continue to satisfy, the threshold conditions in order to become authorised. The FCA will consider whether the firm is ready, willing and organised to comply, on a continuing basis, with the requirements and regulatory standards that apply.

Actions one firm was taking to improve its own standards
One firm had employed a management consultancy to review its policies and procedures and was in the process of making significant changes.

It recruited new board members, including a compliance director. Its compliance function was also strengthened with a new compliance manager and an expanded Quality Assurance (QA) team more suited to the scale, nature and complexity of the business. It was developing a monthly compliance report for board review, covering completed and planned compliance activities and Treating Customers Fairly (TCF) management information (MI). It developed a new commission structure linked to QA results, which included TCF measures. The firm also revised its arrears handling policies and developed a new vulnerable customer policy.

The firm's management held daily change meetings and cascaded developments to staff. Training was delivered on how to identify and deal with vulnerable customers and set up sustainable repayment plans. Staff appeared to appreciate and understand the new approach, claiming they preferred seeking to help customers to repay their debts in an affordable way rather than dealing with high levels of customer complaint and dissatisfaction. These developments were, however, relatively new and ongoing training was required to ensure that the changes were fully embedded.

3.3 Strategy

All of the firms we visited were undergoing strategic reviews, largely in response to regulatory change. In addition, firms had experienced changes in their ownership and/or management structures just before, or at the same time as, we conducted our review.

However, in most cases there was little evidence of effective strategic planning in the past. Firms appeared to have been run in a largely reactive way, often with no clear longer term strategy and little evidence of forward planning.

There was a lack of specific planning and strategy around the collections and recovery process. Some firms appeared to have not adequately anticipated or prepared for the volume and range of arrears cases they were handling. We found that firms' key functions such as compliance and complaint handling were inadequately resourced, or in some cases non-existent. While most firms chose to have dedicated teams for dealing with vulnerable customers and those in financial difficulties, they were often short-staffed and not adequately trained to deal with complex arrears cases.

We also saw significant correspondence backlogs dating back weeks and months at a number of firms, including correspondence from debt advice agencies and debt management firms on behalf of customers experiencing financial difficulties. Unprocessed correspondence included medical evidence and debt management plan offers, meaning these firms were unsighted on the reasons why many of their customers were not paying, and in many cases these customers were still being chased for their debts through daily letters, emails and phone calls. In some cases firms had failed to forecast a surge in arrears and default due to the impact of the rule changes limiting the use of rollovers, which had crystallised defaults for customers who had previously been delaying the inevitable through repeat rollovers.

Firms that failed to forecast and prepare for regulatory change
A firm did not appear to have effectively managed and monitored the impact of the rule changes limiting the use of rollovers. It had failed to forecast the significant surge in volume of arrears cases that would result from a change to its lending policies as customers who previously used rollover and relending options, sometimes habitually, could no longer do so. Despite the sudden changes in policy, the firm had not put suitable safety nets in place to deal with these customers (for example by proactively communicating with or offering customers forbearance options). Instead those who could not pay on time incurred charges and fell into the firms' normal collections cycle. The firm's financial difficulties team was not appropriately resourced or trained to cater for the number of affected customers and the range and complexity of cases. As a result the team developed significant account handling backlogs.

This led to delays in customers being offered appropriate forbearance and the firm continuing to contact customers to chase their debts even where the customer had sought to notify it that they were in financial difficulties. The firm decided to temporarily suspend default interest for all customers in arrears to mitigate some of the consumer harm as it recruited staff to clear the backlog. The firm is currently reviewing what happened and putting in place measures to remediate these problems.

3.4 Governance and controls

In general, we found that firms appeared to lack adequate governance structures and risk management processes. In too many cases this resulted in conduct that fell short of expected standards. Sometimes management were unaware of this conduct until we presented it to them. Frequently firms' systems and controls appeared to have failed to keep pace with their rate of growth.

Some firms had made recent significant improvements. Improvements made included, for example, establishing regular board meetings, developing risk registers and, where appropriate, investing in a 'second line' of quality and compliance oversight, independent of team leaders and managers within the collections area. Some firms had set up a risk committee to ensure appropriate oversight, or appointed a compliance director at board level to ensure visibility of conduct issues at the highest level.

Most firms had developed new policies and procedures specifying how staff should deal with customers in arrears, including vulnerable customers. A minority of firms did not previously have policies and procedures covering the fair treatment of customers in arrears and only began to develop these following FCA interventions.

Most firms produced management information (MI) that was largely limited to financial performance. Some firms had recently introduced or were in the process of introducing MI on the fair treatment of customers, including the success or failure rates of repayment arrangements, quality assurance (QA) results and complaints data. However, where it had been introduced, effective root-cause analysis was not always carried out. So, for example, in a number of firms we saw recurring or systemic IT systems problems that were causing significant harm, and customer complaints, but while frontline teams were trying to tackle individual customer issues, the lack of overall monitoring meant that the underlying causes and affected population of customers were not being identified.

Some firms did not have effective basic compliance functions appropriate to their size and the nature of their business. For example, one relatively large firm was reliant on occasional input from an external compliance adviser and was unaware of the existence of the specialist sourcebook for consumer credit, CONC. While another did not have adequate resources or staff with the necessary knowledge of the firm's procedures to respond adequately or promptly to a request for information during our review. Most firms did some basic compliance checks on frontline agents, some conducted by team leaders, but they generally lacked a compliance approach with the requisite authority, expertise and resources that had a broad oversight of - and access to - the whole of the business from policies through systems to front-line delivery, in order to assess their adequacy and effectiveness.

Failure to comply with statutory obligations in respect of annual statements
Some firms were not complying with their statutory obligations to provide customers who had not repaid their loans within 12 months with an annual statement. We have identified firms that had failed to meet this obligation but had still applied interest and charges, and we are working with them to rectify the situation.

Where compliance monitoring was being carried out, it often lacked sufficient focus on key requirements of CONC and whether the customer was being treated fairly. For example, most firms checked whether agents were complying with the Data Protection Act, but they did not properly evaluate compliance with the requirement in CONC to treat customers with due consideration and forbearance. In some cases this was indicative of a wider cultural problem as well as a lack of familiarity with the detailed standards set out in CONC.

Some firms had implemented or were in the process of implementing new QA schemes that should help improve standards and consistency and give senior management better insight into what is happening on the frontline. This generally involved the review of a sample of phone calls with customers to assess whether the way the firm had dealt with the customer was compliant with regulation and in line with the firm's policies. In many cases the results of these assessments would be fed back to individual agents and would affect how much commission they earned that month. However, these procedures were not always achieving what firms intended, for example:

- QA schemes were often focused on measuring adherence to process, such as whether staff kept within targets set by the firm for 'call wrap-up time' (the time it took staff to carry out actions or make notes at the end of a phone call), rather than customer outcomes. Some firms had recently introduced treating customers fairly measures to marking criteria, although these measures were generally not sufficiently developed and staff required more training on how to identify poor practice.

- QA practices tended to review individual calls in isolation, rather than the overall experience of, and outcome for, the customer.

- Some firms were not yet effectively reviewing the outcomes of QA checks and conducting root cause analysis to feed back findings to frontline staff and deliver improvements.

Firms were generally moving away from staff targets and incentive schemes based solely on cash collected, with most recognising that these risk incentivising non-compliant behaviours by collections staff. Firms were moving toward schemes that included treating customers fairly measures, and were, for example, making deductions from staff bonuses or cancelling that month's bonus where an agent had low QA scores.

Some firms outsourced the management of some of their accounts in arrears to third party debt collection firms. We had similar concerns about the effectiveness of the way firms monitored these third parties' compliance with FCA rules. One firm had not conducted any compliance monitoring of the accounts that it outsourced for collection. Where firms did do this, we found that monitoring and QA were still at an early stage of development with a similar focus on individual calls and whether the debt collection firm was adhering to service level agreements and process, rather than providing assurance that it was delivering fair customer outcomes in line with our principles and the requirements of CONC.

3.5 Shortcomings in firms' systems and processes

In every firm we saw some form of systems or process failing that had resulted in errors such as account balances being miscalculated, fees or charges that the lender was not contractually entitled to charge being added to customers' accounts, customers being given incorrect information, customers being pursued for wrong amounts, and payments being taken (or not being taken) at the wrong times.

Some firms also experienced problems and delays recognising and reconciling incoming payments. So sometimes even where the customer had made the required payment the firm had not ceased collections activities, had applied further interest and charges, or sought (and sometimes taken) duplicate payments.

Many of these issues were only identified or dealt with due to our thematic review or parallel interventions by the FCA. We found that in most cases when these issues arose they were not picked up in monitoring and/or were not effectively escalated to senior managers, so the problems and their root causes were not identified soon enough. Often firms treated systems failures purely as technical issues that needed fixing and had not considered the impact on their customers or whether it was appropriate to put resolutions and redress in place to address these.

The incidence of these sorts of problems is a cause of significant concern. We are working with firms where this has occurred to put these situations right, including paying redress to affected customers where appropriate. We wrote to all HCSTC lenders earlier this year underlining their obligations to put in place systems that are fit for purpose and to ensure they are effectively controlling the risk of system faults. We will be looking closely at firms' systems and controls when we assess their applications for authorisation.

The impact on customers of IT system failures
One firm outsourced or sold debts to third-party debt collection firms. Before passing the accounts over, the firm's IT system had recalculated the amount of default interest applied to those accounts. Because of a programming error it had done so at a higher interest rate than was stated in customers' agreements.

The firm lacked the system controls to detect and guard against such errors. The error was also not identified in the course of due diligence by the debt purchaser. It was only picked up some months later when we queried anomalies in the customer case files provided by the firm. This meant the company that bought these debts had been seeking to collect larger amounts than customers actually owed in practice. The firm has recalculated the amount that customers owed in line with the terms of their agreements and has agreed to engage in a programme of remediation to affected customers.

We also found that some firms had multiple and/or inadequate IT systems, which made it difficult for staff to effectively access, see or record information and update accounts in the time they were given, and created scope for errors and for inconsistencies between systems.

We saw firms consistently fail to clearly and accurately record on their systems contact with customers, the information they received from them, or details of the actions agreed or taken afterwards. Missing or inadequate record-keeping sometimes resulted in firms continuing their collections activities even though it seemed inappropriate in light of the information received. It also hindered the ability of colleagues to effectively deal with the customer and their account in subsequent phone calls or correspondence. We saw customers often having to repeat, sometimes over and over again, the content of communications they had already had with the firm.

In the majority of firms, we also found staff who were not adequately reviewing existing relevant records when dealing with customers. For example, not familiarising themselves with information in their customer database about the customers' circumstances and account histories, even where this information was directly displayed on their computer screens. Failure to recognise this information led to customers being confused or frustrated, and on some occasions to staff giving customers inaccurate information about their debts.

We found that firms had created significant scope for errors to occur. We saw firms that had become heavily reliant on manual workaround processes to try to cope with systems deficiencies that were susceptible to mistakes. Too often customers fell through gaps or failings in the firm's processes, for example, failures to effectively refer customers between different teams within the firm. These failings were frequently not being monitored or picked up in a timely manner and often it was the customer who had to chase the firm.

We saw cases where customers affected by firms' systems problems had tried to report their concerns to the firm, sometimes repeatedly, but staff were slow, or failed, to investigate or acknowledge these. This had the effect of compounding the customers' distress and delaying resolution of the problem.

IT systems limitations and agent errors
One firm failed on numerous occasions to place 'holds' on customers' accounts correctly. These generally provided for a breathing space period, in which collections activity was suspended in order to allow the customer time to seek debt advice or provide documentary evidence of their circumstances. The firm's IT systems however, did not include a 'hold' function. If it was necessary to place the account on hold, agents had to use manual workarounds to keep the account out of the automatic collections workflow. This resulted in accounts being inappropriately categorised and frequently mistakes by agents to apply the workaround meant that holds did not always take effect.

Affected accounts were placed back into the firm's collections workflow. Some customers experienced attempts by the firm to take payments from their bank accounts during the promised breathing space period and others were contacted by the firm seeking payment despite having been told that this would not occur. It was often left to customers to point out in subsequent telephone calls that this should not have happened.

3.6 Treating customers with forbearance and due consideration

We saw some evidence of good practice, in that firms had recently become more aware of the need to consider how they engaged with their customers at each point in the customer journey and how this affected the overall outcome for individual customers. However, all too often we saw evidence of firms dealing with customers in ways that had led to poor outcomes.

The poor outcomes we witnessed very often had their roots in poor lending decisions. Although firms' lending decisions were outside of the scope of our review, we could see from our analysis of customer accounts that in many cases firms had provided new loans, refinanced loans or re-lent to customers in situations where they had grounds to suspect that customers were at risk of, or already in, financial difficulties. Poor arrears handling often compounded bad lending and relending decisions, with firms failing to anticipate that these would eventually crystallise in default, or to provide an effective safety net to help customers out of a cycle of borrowing. Often, lenders failed to take appropriate account of the way that their lending decisions had contributed to the customer's circumstances, resulting in a failure to treat the customer with due consideration once he or she was in default.

3.7 Early identification of customers in financial difficulties

A common theme across all the firms we examined was that customers in arrears who were, or might be, in financial difficulties or in vulnerable circumstances were not always recognised at the earliest opportunity, or at all in some cases. Firms were having poor interactions and dialogue with customers, and we saw a minority of firms that consistently did not seek to establish the reasons for the missed payments where they made contact with customers who were unable to pay. This was an area where most firms recognised they needed to do more to ensure their policies and procedures and training for staff were adequate, and we saw their approaches improve over the period of our review.

Collections agents in a number of firms, when interviewed or observed, appeared to have a low awareness of the ways in which priority bills, essential living costs, over-indebtedness and changes in their personal or financial circumstances might affect customers' ability to meet repayments. We observed instances where agents missed the significance of indicators or triggers presented by customers.[9]

In part, a lot of the problems we saw were due to the failure by firms to adequately record information, including communications with customers, on their systems. Although we saw improvements taking place, no firm consistently identified and took account of relevant information they already held on their IT systems about customers' personal or financial circumstances, including their borrowing and repayment histories. We found instances where firms' systems recorded that customers had notified them of financial difficulties due to personal circumstances (e.g. illness or bereavement), but collections agents had not reviewed this information before chasing customers for missed payments.

We found that some firms had teams that dealt with all types of cases while others had generalist teams on the frontline, which acted as gate-keepers to specialist teams for dealing with financial difficulty and more time-consuming complex cases. A number of firms referred all cases where a customer was dealing with a third party debt adviser to a specialist team. In all of the firms we reviewed that had a specialist team, we observed instances where frontline staff did not identify when it was appropriate to refer customers on and/or escalation procedures were not applied properly so customers were either not referred at all or were referred at a later stage.

Even where firms had such teams, we found some lacked the capacity to deal with the volume of arrears and were often staffed by people without the specialist knowledge or skills needed to deal with vulnerable customers and those in financial difficulties. For example, some agents we spoke to who were tasked with considering whether to accept customers' repayment offers were unaware of the guidance on expenditure in the Common Financial Statement[10] (or any equivalent guidance) or could not articulate what was meant by mental capacity.

9 To accompany our occasional paper on Consumer Vulnerability (published on 23 February 2015) we have collated and presented, in a Practitioner's Pack, examples of good practice in identifying and interacting with vulnerable customers which may support firms to understand what they could be doing to generate better outcomes for consumers in vulnerable circumstances. www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-8

10 The Common Financial Statement budgeting tool, facilitated by the Money Advice Trust. www.cfs.moneyadvicetrust.org/

Failing to record and take account of information provided by a customer
We listened to a call from a collections agent to a customer in arrears who had missed a number of rescheduled repayments under an arrangement. The customer explained that he was grieving for the unexpected death of his son and had to stop working due to illness. His income had also taken a shock from the costs of the funeral and he had been unable to meet the repayments.

The firm operated an escalation route to a dedicated team for sensitive situations such as bereavement, but the agent seemed unaware of this option, so the customer was not referred. The call was unexpectedly terminated. The agent did not make a note of the call on the system nor refer the account to a manager or through the escalation route so the customer's telephone numbers were placed back into the automated dialler to be called again later that day.

3.8 Directing customers to sources of free and independent debt advice

Firms should provide any customer showing signs of actual or possible repayment difficulties with contact details for sources of free and independent debt advice. This applies whether the customer is in actual arrears or not. In addition, where appropriate, firms should direct customers in default or in arrears difficulties to sources of free and independent debt advice.

Providers of free and independent debt advice can help customers who are, or may, experience repayment difficulties, particularly where customers are struggling to meet multiple commitments or lack the capacity to effectively represent themselves in negotiations with their creditors. This can be of benefit to lenders too, as good debt advice can help customers to work through their budget, review their options and develop sustainable solutions to clear their debt.

However, we found that these customers were not consistently informed of the availability of free and independent debt advice and sometimes firms missed opportunities to give this information to individual customers where it would have been appropriate to do so.

Some firms relied on generic signposting to sources of free and independent debt advice in automated letters or emails that were triggered at certain stages of the arrears process, normally based on the number of days overdue. While incorporating debt advice contact details in standard communications is welcome and could clearly help many customers, some firms were not considering, or were not consistently considering, whether the provision of information about free and independent debt advice information might be appropriate and timely for the individual customer and in the given situation at the point they were directly engaging with them. In too many cases the communication was sent some time after this information would have been useful, for example where the customer had already entered into a repayment arrangement or made a payment.

Although in some firms we observed staff providing customers with information about sources of debt advice in the course of conversations about their individual difficulties, in other firms we observed conversations where it would have been appropriate to make the customer aware of the existence of free and independent debt advice where staff did not do so and often appeared unaware of our guidance or of the circumstances in which it might be appropriate to alert customers to this option.

Failure to consider when it might be appropriate to direct customers to free and independent debt advice
Within one month of missing his payment, a customer spoke with the firm on three occasions, informing the firm that the reason he had missed a payment was because his partner had lost their job, the household income had reduced by £1000 and he was struggling to pay his priority bills. The customer was not told during any of those conversations that there were sources of free and independent debt advice which might be able to help him.

After the customer had been in arrears for 60 days, the firm sent him a standard letter, which stated that if he made contact with the firm they could provide contact details of providers of free and independent debt advice. This letter was followed by a further 12 letters, none of which sign-posted him to free and independent debt advice. The customer entered into a repayment arrangement after 90 days in arrears but it was not until he had been in arrears for 174 days that a letter was sent which provided actual contact details for sources of free and independent debt advice.

We also found some firms did not provide customers with the FCA's HCSTC information sheet when rolling over loans or the FCA's default information sheet when issuing default notices.

3.9 Agreeing appropriate solutions

We found that some firms were not consistently considering their customers' individual circumstances and financial difficulties when discussing the options available to them. In a minority of cases we found instances where firms were unsympathetic and inflexible where a customer appeared to be experiencing distress and financial difficulty.

A range of forbearance measures were offered across the firms we reviewed, for example, giving customers breathing space during which collections calls, letters and texts were suspended, agreeing to adjust due dates, waiving fees and charges, and offering arrangements to repay debts over a longer period of time.

In some firms – generally those whose efforts to implement improvements to their approach were most advanced – collections agents were frequently opening conversations with customers in arrears by asking why they had missed their payment, and were openly exploring the forbearance options they could offer. These firms were, however, the minority.

On these occasions where firms entered into effective dialogue with customers, we saw a range of approaches to agreeing repayment arrangements, usually depending on the nature of the engagement with the customer and the circumstances they described. Most firms used some form of income and expenditure template that customers could fill in for themselves where the firm considered it was appropriate. In some cases agents would run through the customer's income and expenditure on the phone. A discussion or assessment of a customer's income and a breakdown of their expenditure was more likely to occur for customers with obvious flags of difficulties, for example serious illness. One firm offered customers the opportunity to use online calculator tools to work out the length of a repayment arrangement.

Where firms did enter into dialogue with customers, often this resulted in the customer agreeing a repayment arrangement that took account of what they could reasonably afford, and over how long. We observed that many customers seemed pleased with this approach and appeared relieved to have been able to agree an arrangement.

However, while we did see firms and customers enter into what appeared to be affordable and sustainable arrangements, we also saw a high number of failed repayment arrangements, even where customers had proposed the arrangement themselves. For example, we witnessed multiple cases where customers had repeatedly entered into and broken arrangements with firms. Frequently the new arrangement was simply reset on the same terms even though the evidence clearly suggested that this was not sustainable for the customer.

We saw many cases where firms did not consider whether repayment proposals from customers seemed too high or unsustainable. This was even where there was obvious evidence or at least some indications, either on the firm's own records or from customers themselves, that this might be the case. Managers and agents in some firms told us that they were alert to a risk that customers may be over-optimistic and offer more than they can afford, or might agree to a plan simply to get the firm 'off their back' for a while. However, this risk was not reflected in most firms' policies and procedures or guidance to staff. In some instances the firm's own actions may have created this risk, for example, where firms had sent communications that appeared to pressurise customers to repay their arrears quickly.

Unaffordable and unsustainable repayment arrangements

We observed a firm dealing with a customer who had broken, and reset, a repayment arrangement to repay his arrears ten times over 11 months. The customer had engaged with the firm early, notifying it that he was in significant financial hardship but wanted to attempt to clear his debt. The customer had an erratic payment record which had resulted in further default charges being applied when he missed repayments.

Despite the firm having contact with the customer each time they reset the arrangement, there was no record of any discussion around why the arrangement kept breaking nor exploration of his income and expenditure to support development of a more sustainable arrangement. The repayment arrangement was reset for the same amount each time. The customer had also not been directed to free and independent debt advice.

We also saw situations where forbearance options were more limited. Some firms had an initial strategy to obtain repayment of arrears quickly, where they frequently pushed for immediate payment in the first instance, and failing that, pressed for repayment on the customer's next payday, without appearing to consider whether this was pressurising customers to pay more than they could afford. Failing that they required customers to repay arrears over pre-defined periods, typically over three pay periods, irrespective of their individual circumstances and what they could afford.

One firm had a policy of refusing to allow customers to enter into an arrangement to spread repayments of their arrears over time unless they made a partial payment there and then. The policy was applied rigidly, including in cases where customers said or offered to show evidence that they were unable to pay anything immediately, for example, because they did not expect to get paid for a few days or weeks, or had urgent priority expenses. One firm did not consider that a customer who had been made unemployed or had their hours reduced was in financial difficulty if they had been in temporary employment or on zero hour contracts when they took out the loan, even though the firm itself lent to the customer on the basis of that employment status. Firms that adopt such blanket policies and are unwilling to adapt their approach in light of the circumstances of individual customers risk failing to comply with the obligation to treat each customer in default or in arrears difficulties with forbearance and due consideration.

It was clear that for some firms, repeatedly rolling over loans rather than considering forbearance options for customers who could not repay on time, had historically been part of their model. Although firms' policies changed following the introduction of rules in July 2014 limiting the number of rollovers they are permitted to offer, we saw a handful of staff who were still recommending rollovers to customers who said they could not afford to pay their loans. Where this occurred we have required firms to rectify the situation.

Some firms had fixed requirements for customers to submit specified documentary proof of their circumstances before they would agree to offer forbearance. Requesting proof of a customer's situation in appropriate circumstances is quite legitimate. However, some firms failed to give due consideration to whether provision of proof was relevant or fair in the circumstances. In some instances the documentation requested was unreasonable or had no bearing on the issues at hand, or the time given to provide it was unreasonable or inflexible.

In a number of cases, we observed firms failing to appropriately prioritise their incoming correspondence to identify this documentary proof in an effective or timely way. Some firms failed to review this evidence at all when provided, and the detailed information contained in these documents did not appear in many cases to materially influence the firm's decision about how to handle the customer's case. Other firms, however, adopted more flexible approaches training and empowering staff to make judgements as to whether, or what, evidence was reasonable in the circumstances.

We also saw customers who contacted firms before their original payment due date to tell them they could not afford to repay their loan on time using the continuous payment authority (CPA) set up when they took out the loan, due to them experiencing financial difficulty. A minority of firms had a blanket policy to ignore all such requests and supporting evidence from customers and sought payment by CPA on the due date anyway, refusing to reassess the repayment arrangement or consider reasonable payment proposals from customers until the scheduled payment was missed, in breach of CONC rules and guidance.

3.10 Dealing with debt advisers

Most firms engaged with debt management firms and free debt advice providers acting on behalf of their customers, typically putting recovery action on hold when notified of their involvement and routinely accepting debt management plan repayment offers. However, we saw cases where this was not always done effectively or efficiently. For example, we saw some firms that had been slow at dealing with debt management and advice providers, and had only recently put in systems and processes designed to efficiently share information and speed up the creation of arrangements and allocation of payments to customers' accounts. Some firms failed to explain to third parties the reasons why they had not accepted the repayment offers. Common reasons included where the firm had not been informed how offers had been calculated or because customer information they required was incomplete. This risked unnecessarily drawing out the process as the debt management and advice providers were left unaware of what they needed to do in order to help agree an appropriate solution for the customer.

One firm, however, had routinely challenged offers made by debt management firms regardless of the information provided about the customer's disposable income and circumstances. It used the freezing of interest as a bargaining chip to leverage better terms from debt management firms making this conditional on an increased payment offer. We also witnessed instances where it sought to bypass third parties altogether and come to a direct arrangement with the customer, and where it continued collections calls, texts and emails to the customer even though it was receiving payments via a debt management provider.

3.11 Communicating with customers

During the review, we saw a range of misleading and occasionally threatening correspondence from lenders, some of which was sent to vulnerable customers. Misleading communications we witnessed included:

- Stating that debts will or may be referred to an external collection firm when this was not the case. One firm collected older debts under a different trading name and implied in some communications or over the phone that it was a different firm working on behalf of the lender. One firm had stopped using debt collection firms but had failed to update its communications library or disseminate this change of policy to staff, so customers were still being told that recovery of their debts might or would be outsourced.
- Although it had no policy to do so in practice, one firm sent customers text messages threatening visits to their home or place of work.
- Some firms had sent default notices implying that they would take legal action against the customer although they told us they had no intention to litigate.
- The majority of firms communicated misleading or confusing information about the effect of payment or non-payment on their customers' credit ratings. Some firms implied that customers could avoid the reporting of their arrears to credit reference agencies if they subsequently made a payment. In some cases confusing messages appeared to be an unintentional consequence of firms not explaining clearly enough their obligations to report customers' credit account information, including arrears and defaults, to credit reference agencies.

3.12 Fees and charges

We visited firms and reviewed customer case files before the introduction of the price cap, which limits the amount HCSTC firms can charge.[11] A majority of the firms we examined changed their approach to fees and charges during our review, and these had tended to have

11 From 2 January 2015 all high-cost-short-term loans must comply with the price cap rules. There are three elements to the price cap:
- an initial cost cap of 0.8% per day – interest and fees charged must not exceed 0.8% of the outstanding principal per day
- a £15 cap on default fees – if borrowers default, fees must not exceed £15. Firms can continue to charge interest at the same rate as before default (but not in excess of 0.8% per day)
- a total cost cap of 100% - borrowers must never pay more in fees and interest than 100% of what they borrowed

come down from significantly higher levels in the recent past. Some firms had recently reduced the period over which they charged default interest, typically to the range of 30 to 60 days. Most firms had introduced grace periods, typically between three and seven days, which meant that customers who were not in difficulties but whose payment was delayed by a few days, perhaps due to late payment of their salary, did not incur a default fee.

Firms are obliged to consider waiving fees and charges where a customer is in financial difficulties. The firms we reviewed did generally consider whether or not to waive fees and charges where a customer was in financial difficulties in most cases, and frequently did exercise their discretion to waive fees.

All firms we examined gave individual collections agents some discretion to waive and freeze fees, charges and interest where they recognised that a customer was in financial difficulties and should be given forbearance, albeit some firms had narrower definitions of when they would consider this to be the case. Most firms had policies to suspend or waive default interest when a customer entered into a repayment arrangement directly with the firm, some at the point it was agreed and others at the point when the first payment was received.

Most of the firms we reviewed had a general policy to waive or suspend default fees and charges after contact with a debt management firm or free and independent debt adviser acting on behalf of a customer. However, the point at which firms did so was often affected by delays in dealing with requests and notifications from such third parties and in some cases these were caught up in correspondence backlogs.

4.
Conclusion and next steps

As a result of our evidence being gathered over a period of significant change, our findings represent a series of snapshots in time of evolving firm practice and customer experiences. For the most part, the firms we examined still exhibited a number of shortcomings in their approach to arrears and collections at the end of the process. Some of these were relatively minor, whilst others require more significant effort to put them right.

We have given feedback to each of the firms within our sample about the good and poor arrears and forbearance practices we observed within their businesses. In response to the issues we identified during the review, firms have made improvements to their systems and controls, and how they treat their customers. In a number of cases we have investigated or are still investigating further where we found unfair practices. We have taken swift action to stop poor practice and mitigate risk and also secured voluntary commitments to provide redress to customers who have suffered harm as a result of unfair treatment.

In January 2015, we contacted all HCSTC firms to remind them that if they want to continue to conduct regulated consumer credit activities, they must demonstrate to us they are complying with the rules and treating customers fairly, including when customers struggle to repay a loan.[12]

Most firms that held an interim permission for HCSTC and wish to continue engaging in regulated consumer credit activity must have submitted applications for authorisation by 28 February 2015. The authorisations process will scrutinise in-depth all lenders seeking the HCSTC permission and those that cannot demonstrate that they meet our threshold conditions will be refused.

All HCSTC firms should take careful note of the findings of this review and consider what improvements they may need to make to their business practices in light of it, including whether:

- their systems are fit for purpose
- they have established and implemented clear, effective and appropriate policies and procedures
- their staff are adequately trained
- they need to take steps to provide redress to customers affected by any past unfair treatment of customers

12 Dear CEO letter - The FCA's expectations of high-cost short-term lenders, sent on 21 January 2015. www.fca.org.uk/your-fca/documents/dear-ceo-letters/dear-ceo-letter-hcstc-firms

Abbreviations used in this paper

CCA	Consumer Credit Act 1974 (as amended)
CMA	Competition and Markets Authority
CONC	Consumer Credit Sourcebook (FCA Handbook)
COND	Threshold Conditions (FCA Handbook)
CPA	Continuous Payment Authority
DISP	Dispute Resolution: Complaints (FCA Handbook)
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
GEN	General Provisions (FCA Handbook)
HCSTC	High-cost short-term credit
MI	Management Information
OFT	Office of Fair Trading
PRIN	Principles for Businesses (FCA Handbook)
QA	Quality Assurance
SYSC	Senior Management Arrangements, Systems and Controls (FCA Handbook)
TCF	Treating Customers Fairly
VREQ	Voluntary Requirement

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