

Assessing creditworthiness in consumer credit

Proposed changes to our rules and guidance

Consultation Paper

CP17/27**

July 2017

How to respond

We are asking for comments on this Consultation Paper (CP) by 31 October 2017.

You can send them to us using the form on our website at: <https://www.fca.org.uk/cp17-27-response-form>.

Or in writing to:

Consumer Credit Policy
 Financial Conduct Authority
 25 The North Colonnade
 Canary Wharf
 London E14 5HS

Email:

CP17-27@fca.org.uk

How to navigate this document onscreen



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takes you to helpful abbreviations

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1 Summary

Why we are consulting

- 1.1** We are proposing changes to our rules and guidance on assessing creditworthiness, including affordability, in consumer credit to clarify our expectations of firms.

Who this applies to

- 1.2** Who needs to read this whole document
- consumer credit lenders
 - peer-to-peer platforms, and
 - trade bodies representing these firms
- 1.3** Who only needs to read this summary
- other consumer credit firms and trade bodies, and
 - consumer organisations
- 1.4** Who doesn't need to read this consultation, but it affects them
- consumers who take out a loan or other credit product

The wider context of this consultation

- 1.5** Consumer credit plays an important role in society and is a largely beneficial activity, enabling borrowers to purchase goods and services and spread repayments over time.
- 1.6** In our 2015/16 Business Plan¹ we highlighted a risk of potential harm to consumers from poor culture and practice when assessing affordability in consumer credit. We have since undertaken research to establish how firms are interpreting and applying our current rules and guidance on creditworthiness assessments, which we have published alongside this consultation.² Consumer credit has also been a particular focus of the Financial Policy Committee (FPC), an independent committee at the Bank of England (the Bank), following the recent rapid growth in consumer credit lending.

1 Financial Conduct Authority: Business Plan 2015/16 (March 2015).

2 Assessing creditworthiness in consumer credit: Summary of research findings (July 2017) – www.fca.org.uk/publication/consultation/cp17-26-research-findings.pdf



- 1.7** Further background on these issues is in Chapter 2, and we set out our approach to regulating the consumer credit market in Chapter 3. A summary of the research findings and our current rules and guidance is in Chapter 4.
- 1.8** We have also published an Occasional Paper (OP 28)³ alongside this consultation. This sets out an economic framework for understanding why unaffordable consumer credit debt can occur and how it might be prevented. We hope the OP will provide a helpful context for considering the proposals in this consultation.

What we want to change

- 1.9** Creditworthiness comprises credit risk and affordability. Credit risk is the risk to the lender that the customer will not repay the credit, while affordability is about how difficult it may be for the customer to repay. Credit risk may therefore be seen as a 'lender-focused' test, while affordability is 'borrower-focused'. We recognise that there may often be considerable overlap between the two, and that in practice firms may combine these aspects into a single assessment. We want to ensure that appropriate account is taken of affordability where it is not fully aligned with credit risk.
- 1.10** Our research findings, and our wider experience of regulating consumer credit, have confirmed that most firms do consider affordability in some form and appear to have implemented relevant processes. The majority of existing processes we have seen in the market appear appropriate. However, practices vary considerably, given the challenges in assessing affordability in light of a customer's financial situation. There is evidence both of under-compliance with our rules but also of firms having procedures which may be unnecessarily costly or restrictive.
- 1.11** In light of this, we consider it would be helpful to amend our rules and guidance to clarify what we expect of firms in assessing creditworthiness. This is in line with our commitment to improved transparency in our Mission.⁴ We also believe this clarification will make it easier for us to supervise the market.
- 1.12** We do not think our basic approach to creditworthiness needs any fundamental change. It is based around high-level principles with an emphasis on proportionality. We consider that outcomes matter more than process, and firms can satisfy themselves on affordability in different ways. Given that the consumer credit market is so broad and varied, we do not believe it is appropriate to prescribe in detail particular checks firms should make, or specific information they should obtain or verify, either generally or in particular sectors.
- 1.13** However, we think it is important to clarify in our rules:
- the distinction between affordability and credit risk
 - the factors that should be used when designing affordability checks that are appropriate and proportionate in relation to individual lending decisions
 - the appropriate role of income and expenditure information in lending decisions

³ OP 28 Preventing financial distress by predicting unaffordable consumer credit agreements: an applied framework (July 2017) – www.fca.org.uk/publications/occasional-papers/occasional-paper-no-28-preventing-financial-distress-predicting

⁴ Our Mission 2017 – www.fca.org.uk/publications/corporate-documents/our-mission

- our expectations around firms' policies and procedures which should focus on outcomes, having regard to the risks of the credit and customer characteristics

- 1.14** In particular, our proposed rules introduce a new explicit definition of 'affordability risk'. This sets out the factors which firms should consider when assessing whether the credit is likely to be affordable for the borrower. We do not define credit risk but recognise that it primarily reflects the probability of default, which firms consider in light of their own financial and commercial position.
- 1.15** Firms use a variety of methods and processes to assess credit risk and affordability. These may be automated, manual, or a combination of both. Firms may assess credit risk and affordability together or separately. All of these can deliver good outcomes for customers, and our proposed rules do not prescribe which type of process firms should adopt. Where processes are automated, we do expect firms to have appropriate policies and procedures in place to ensure they can adequately manage any risks associated with those processes. We provide more detail on the variety of processes currently used by firms in the research published alongside this consultation.
- 1.16** We also recognise the significant role played by credit reference agencies (CRAs) in providing data and analytics to firms in the consumer credit market. These include a variety of products relevant to credit risk and affordability. Again, we expect firms to have appropriate policies and procedures to ensure they have a proper understanding of the nature of these products and to manage any associated risks. Issues relating to these products and data are discussed further in Chapter 5, and in OP 28.
- 1.17** In this consultation we focus on the principles that we believe should underpin firms' assessments of affordability, as part of a creditworthiness assessment, and the outcomes we are seeking to achieve. We set out our proposed changes to our rules and guidance in Chapter 5 below, and we include some tables to illustrate our approach and assist firms in their assessments.

Outcome we are seeking

- 1.18** We want firms to make a reasonable assessment, not just of whether the customer will repay, but also of their ability to repay affordably and without this significantly affecting their wider financial situation. This minimises the risk of financial distress to customers and its personal, social and economic implications.
- 1.19** At the same time, we want to avoid being too prescriptive, as this could have harmful unintended consequences, including for the cost and availability of credit. We want firms to take a proportionate approach, which takes into account the costs and risks of the credit for the individual customer and the probability that they may suffer harm as a result of the credit. Firms should decide what is appropriate in the circumstances. We do not want to discourage the use and development of automated systems that may provide more reliable results than asking the customer for large amounts of information.



- 1.20** Making our expectations clearer should make it easier for firms to comply, leading to better outcomes for customers. We expect firms to review their policies and procedures in light of our final rules and guidance and make changes where needed.
- 1.21** These proposals do not affect how affordability is considered for mortgages, which is subject to a separate regulatory regime.⁵

Measuring success

- 1.22** We will evaluate the success of our proposals through our supervision of firms and monitoring regulatory returns and complaints. We may also undertake research or multi-firm work to assess the changes firms have made.

Next steps

- 1.23** We want to know what you think of our proposals. There is a list of specific questions at Annex 1 – please respond to these by 31 October 2017. You can use the online response form on our website or write to us at the address on page 2.
- 1.24** We will consider your feedback when we make decisions about final rules and guidance, which we aim to publish in a policy statement in the first half of 2018.

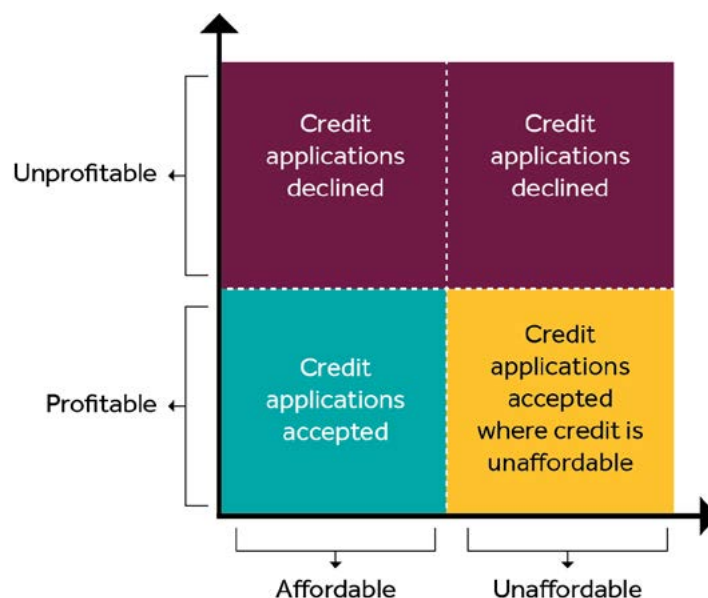
5 In our Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).

2 The wider context

The harm we are trying to address

- 2.1** Consumer credit has a key economic function and is a largely beneficial activity. Most borrowers repay without difficulty and without financial distress. However, there are particular risks in high-cost credit or where customers are non-prime⁶ or vulnerable.⁷ We expect firms to take these risks into account, both in their policies and procedures and when making individual lending decisions.
- 2.2** Most firms have a strong commercial incentive to assess credit risk, including the probability of default. Ultimately a business will only be profitable if sufficient numbers of its customers pay back their loans. On the whole, this should also work in the interests of customers, by preventing them from taking on debt they cannot repay.
- 2.3** As such, there is often considerable overlap between credit risk and affordability. Firms may be able to use the same information to assess both, as part of a single integrated assessment. However, this may not always take sufficient account of the potential for the credit to impact adversely on the customer's wider financial situation and their welfare. For example, the customer should not have to cut back significantly on food or other essential spending, or fail to meet other commitments.
- 2.4** Firms may not have a sufficient incentive to incorporate affordability aspects into their assessments. This misalignment of incentives, and the consequent need for regulatory intervention on affordability, is discussed further in OP 28. The table below illustrates this and identifies customers who may be profitable for firms but for whom credit is unaffordable.

Table 1: Incentives for firms to lend where credit unaffordable



⁶ Non-prime (or sub-prime) consumers are those with an adverse credit history or 'thin' credit file.

⁷ See Our Mission 2017 – www.fca.org.uk/publications/corporate-documents/our-mission



- 2.5** Without a requirement for firms to assess affordability, firms may be motivated to offer unaffordable credit to applicants who they expect to be profitable even if they are at high risk of suffering financial distress. These are the group identified in the bottom right quadrant of Table 1. The extent of this misalignment between firms and credit applicants will depend on the customer's situation and the product characteristics.
- 2.6** Our proposed rules are addressed particularly at lending in the bottom right quadrant of Table 1, where credit is profitable but unaffordable. They are not intended to restrict lending in the bottom left quadrant where firms are satisfied credit is affordable.
- 2.7** In an ideal world there would be no lending in the bottom right quadrant. However, such an outcome is unrealistic, and could only be achieved by denying credit that would actually fall into the bottom left quadrant. This arises from a fundamental characteristic of both credit risk and affordability assessment – that they have a material probabilistic component. At the point credit is granted there will be:
- unforeseeable events that will impact some borrowers that will make the credit unaffordable
 - a level of 'false positives' (credit advanced to borrowers that will turn out to be unaffordable even without an unforeseen event occurring) that cannot be reduced to zero without disproportionate expense and/or increasing the level of 'false negatives' to disproportionate levels
 - a level of 'false negatives' (applications declined when the credit would be affordable) that cannot be reduced to zero without disproportionate expense and/or increasing the level of 'false positives' to disproportionate levels
- 2.8** Nevertheless, we believe that the way lenders assess affordability and include that analysis in their lending decisions can be improved so as to reduce the level of false positives or false negatives without unduly increasing costs for firms. To assist firms' assessments, we are proposing changes to our rules and guidance.
- 2.9** Our proposals are aimed at ensuring firms take into account a customer's wider financial situation. This also reflects the strong consumer protection focus of the Consumer Credit Directive (CCD), which highlights the risks to consumers of over-indebtedness. We want to minimise these risks while at the same time avoiding negative unintended consequences. If assessments are unduly burdensome this could unnecessarily raise the cost of credit or reduce its availability to borrowers who can afford it. It could also make the customer experience less positive.
- 2.10** We do not want firms to view consideration of affordability as necessarily involving cumbersome assessment processes. For example, OP 28 discusses the use of data sources such as Office for National Statistics (ONS) data which may provide a more reliable means of assessing affordability than self-reported application data. Our focus is on the effectiveness of outcomes.

How it links to our objectives

- 2.11** The proposals set out in this consultation primarily advance our consumer protection objective of securing an appropriate degree of protection for consumers. We have also considered competition and market integrity issues.

Wider effects of this consultation

- 2.12** Lending standards are also important for prudential and financial stability reasons.
- 2.13** In developing our proposals, we have liaised with the Bank of England (the Bank) – including the Prudential Regulation Authority (PRA) – and have taken account of the findings and judgement of the FPC.
- 2.14** In particular, we have noted the FPC's judgement that the recent rapid growth in consumer credit could represent a risk to lenders if accompanied by weaker underwriting standards⁸, and have taken account of the recent PRA Statement on consumer credit.⁹ Whereas the PRA Statement is focused on prudential risks, our conduct rules are primarily concerned with ensuring responsible lending at the customer level. We see these aspects as distinct but complementary. Appropriate assessment of affordability for customers should reduce prudential risks, while effective credit risk management should also reduce the risk of unaffordable lending.
- 2.15** We discuss later our role and that of the Bank, PRA and FPC in ensuring that credit markets are sustainable. In particular, the FPC's primary responsibility is to identify, monitor and take action to remove or reduce systemic risks, with a view to protecting and enhancing the resilience of the UK financial system. Systemic risks include those associated with unsustainable levels of leverage, debt or credit growth.
- 2.16** We are also taking this opportunity to set out our strategic aims for the consumer credit market, and details of our other current consumer credit work, including in relation to motor finance. We have also now published our feedback statement (FS17/2) on high-cost credit including our review of the price cap in high-cost short-term credit.¹⁰

What we are doing

- 2.17** Our research findings and supervisory experience suggest that some firms do not understand our current rules and guidance on creditworthiness assessments, and may be taking too lenient or too draconian an approach. As a result, they may be granting credit which is unaffordable, potentially leading to financial distress, or alternatively restricting credit unnecessarily or adding unnecessary costs.
- 2.18** So we propose to change our rules and guidance on assessing creditworthiness, including affordability, to clarify our expectations of firms.

8 www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2017/record1707.pdf

9 www.bankofengland.co.uk/pru/Pages/publications/statement040717.aspx

10 [FS17/2 High-cost credit including review of the high-cost short-term credit price cap \(July 2017\) – www.fca.org.uk/publications/feedback-statements/fs17-2-high-cost-short-term-credit](http://www.fca.org.uk/publications/feedback-statements/fs17-2-high-cost-short-term-credit)



- 2.19** We are not proposing any fundamental change to our overall approach, which is rooted in proportionality. We want firms to make a reasonable judgement in the individual circumstances, according to the costs and risks to the borrower, and to adjust their approach where necessary in response to customer outcomes. It is important that firms retain the flexibility to do so, within parameters set by our rules.
- 2.20** However, we want to be as clear as possible about:
- the distinction between affordability and credit risk, while acknowledging that in practice there is often significant overlap between the two
 - the factors that firms should use when deciding the proportionality of assessments and in their decisions on what information to use and/or verify in the assessment
 - the role of income and expenditure information
- 2.21** We are also clarifying our expectations around firms' policies and procedures for assessing creditworthiness. This is important as, even where firms are confident they are making reasonable assessments, they may not always be able to evidence this. This may particularly be the case where processes are highly automated, or rely significantly on data or products from CRAs or other external sources, and where firms may struggle to demonstrate how these mitigate affordability risks for their customers.
- 2.22** Our proposals will enable us to supervise the market more effectively. In particular, where we have concerns, we will be able to request details of a firm's policies and procedures, and how it has implemented these in individual cases. This will enable us to test outcomes against expectations and to assess compliance with our rules.
- 2.23** We do not consider that the proposals set out in this consultation will add more than minimal costs for firms that are complying with existing rules. We explain the reasons for this in Annex 2, and provide a compatibility statement at Annex 3.
- 2.24** The Occasional Paper (OP 28) published alongside this consultation builds on the findings of OP 20¹¹ last August. It sets out an economic framework for understanding why unaffordable consumer credit debt can occur and how it might be prevented. It then uses this framework to examine the predictability of financial distress among consumers applying for high-cost short-term credit (HCSTC). In particular, OP 28 highlights the importance of a customer's overall indebtedness, and considers whether financial distress can be predicted based on a debt-to-income (DTI) ratio. The OP finds that HCSTC applicants who have outstanding consumer credit debts (excluding mortgage or government student loan debt) near or above their annual individual net income have a significantly higher risk of suffering financial distress.
- 2.25** We propose to clarify in our rules that affordability risk may be high where the total value of the customer's debts relative to their income is high. This may be a signal that a more rigorous assessment is needed. However, we are not proposing to require firms to incorporate debt-to-income ratios (or similar) into their assessments. As discussed in Chapter 5, there may be other ways that firms can satisfy themselves on affordability, using different metrics, and data limitations may make such assessments impracticable.

11 [OP 20 Can we predict which consumer credit users will suffer financial distress? \(August 2016\) – www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf](http://www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf)

- 2.26** We hope the OP will provide a helpful context for considering the proposals in this consultation, and will further stimulate debate on the issues.

Equality and diversity considerations

- 2.27** We have considered the equality and diversity issues that may arise from our proposals.
- 2.28** Overall, we do not consider that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. However, we will continue to consider potential impacts during the consultation period and will revisit our assessment when publishing final rules and guidance.
- 2.29** Our aim is to reduce the risk of borrowers falling into financial difficulties because of poor creditworthiness assessments. We want to ensure an appropriate balance between, on the one hand, denying credit to those who cannot afford to repay and so are likely to suffer financial distress and, on the other, avoiding excessive requirements which may lead some firms to limit lending unnecessarily or add unnecessary costs.
- 2.30** Based on our current understanding, we expect that, overall, consumers will benefit from the proposals in this paper, but that there will be particular benefits for the protected groups. These consumers may be disproportionately vulnerable to the risks of, and disproportionately affected by, unaffordable credit. They may also have a particular need for ready access to affordable credit to bridge gaps between income and expenditure or cope with short-term spending needs or income shocks.
- 2.31** The equality impact assessment process is ongoing and will not be completed until we develop and publish our final policy and rules and guidance. We welcome your views on any equality and diversity issues you believe might arise from our proposals.



3 Our approach to regulating consumer credit

- 3.1** In this chapter we set out our approach to regulating the consumer credit market, to enhance consumer protection and address actual and potential harm.
- 3.2** We discuss the characteristics of the market and how we think about sustainability in this context. We describe the respective roles of the FCA, the Bank and the PRA in addressing different kinds of risk, and illustrate this with examples of our previous interventions. Finally, we explain how this applies to creditworthiness, including affordability, which is a key element of a sustainable market.

The consumer credit market

- 3.3** According to the most recent Bank data, there is currently almost £200bn of outstanding consumer credit debt.¹² This represents an increase of 10.3% over the previous 12 months.
- 3.4** Of this, £68bn is outstanding on credit cards (an annual growth rate of 9.1%) and almost £132bn on other consumer credit (a 10.9% increase over the previous 12 months).
- 3.5** The recent growth in consumer credit lending has been broad-based across different segments of the market, but with particular growth in dealership car finance, credit cards and personal loans. The FPC has noted¹³ that contributory factors include an easing in credit supply conditions and intense competition in parts of the market. This has been demonstrated by, for example, longer 0% periods on credit card balance transfer deals and an increase in maximum loan limits on personal loans.
- 3.6** We have undertaken a market study on credit cards, and are proposing rule changes to address our concerns. We are also undertaking work on motor finance and high-cost credit products.¹⁴

Risks from credit growth

- 3.7** The FPC noted at its 22 March 2017 meeting that recent growth in consumer credit lending posed potential risks to financial stability. These could arise directly from potential losses to lenders on consumer credit portfolios. In addition, high levels of debt, or an abrupt reduction in credit supply, could affect consumption and broader macro-economic stability, and hence the resilience of the financial system.

¹² Bank of England Statistical release: Money and Credit: May 2017 (published 29 June 2017) – www.bankofengland.co.uk/statistics/Documents/mc/2017/may/moneyandcredit.pdf

¹³ www.bankofengland.co.uk/publications/Documents/records/fpc/pdf/2017/record1704.pdf – see also www.bankofengland.co.uk/publications/Documents/news/2017/008.pdf

¹⁴ See Chapter 6 below.

- 3.8** The FPC judged that underwriting standards should be monitored closely. It therefore supported a review launched by the PRA into the credit quality of new lending by PRA-regulated lenders, and the FCA's review of its rules and guidance.
- 3.9** At its 21 June meeting, the FPC concluded that effective governance at firms should ensure that risks are priced and managed appropriately and benign conditions do not lead to complacency by lenders. To inform the FPC's assessment at its next meeting of any additional resilience required in aggregate against this lending, it is bringing forward the assessment of stressed losses on consumer credit lending.¹⁵

Consumer credit and financial distress

- 3.10** Consumer credit has an important economic function and is largely a beneficial activity. It enables borrowers to purchase goods and services and spread repayments over time, manage temporary cash-flow shortfalls and plan for the future. It also has wider economic benefits and can help promote growth.
- 3.11** However, some borrowers may experience financial and other difficulties from taking on credit. We refer to this as financial distress. This may happen if a customer is unable to repay debt, in whole or part, or can do so only with wider negative effects. These may include having to cut back on essential spending or increase working hours, or getting into arrears or default on other financial commitments or bankruptcy. It can also affect customers' mental health and have wider social implications.
- 3.12** As a result, a minority of customers may be worse off than if they had not borrowed. A customer not paying back debt also has negative financial implications for the lender as it may incur losses or extra costs.
- 3.13** Financial distress can happen for a number of reasons. In some cases it may be due to a change of circumstances or other matters that the lender or borrower could not have reasonably foreseen. In others, it may be partly or wholly due to irresponsible lending or borrowing. In particular, firms may not exercise sufficient care when making lending decisions or may not treat customers fairly.
- 3.14** Objective measures of financial distress include arrears and default, while subjective measures include customers' perceptions of debt and self-reported wellbeing.
- 3.15** OP 20¹⁶ found that the majority of people holding consumer credit products are not in financial distress and are at low risk of financial distress. Using a narrow objective measure of financial distress (whether someone is two or more payments in arrears on at least one credit product), it found that 2% of individuals with consumer credit debts in the period 2012 to 2014 were in financial distress. This varied significantly by product type, with higher-cost products having higher arrears rates.
- 3.16** The research also used a broader measure which included whether the individual regarded their debts as a heavy burden or was falling behind on some or many financial commitments. Using this, it estimated that 17% of people with outstanding consumer

15 <http://www.bankofengland.co.uk/publications/Documents/fsr/2017/fsrjun17sum.pdf>

16 Based on ONS Wealth and Assets Survey – www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf



credit debts were suffering moderate to severe financial distress. This amounted to some 2.2 million people – or 7% of all individuals with consumer credit.

- 3.17** OP 20 found that people in financial distress are typically younger, with lower incomes, less likely to be employed and have higher debt-to-income ratios. They are also more likely to hold higher-cost credit products. This indicates that affordability assessments may have a relatively greater impact in reducing harm for these types of customer.

A sustainable consumer credit market

- 3.18** One aim of consumer credit regulation is to minimise predictable financial distress by promoting responsible lending and enabling responsible borrowing. This should also promote sustainable well-functioning markets.
- 3.19** At a high level, the consumer credit market can be considered to be sustainable if it is net beneficial for most borrowers and if efficient firms can absorb the losses from defaults and remain profitable. The costs of default are typically priced into the interest rate that firms charge, so customers who repay also need to be able to sustainably support the cost of customers who do not repay.
- 3.20** However, a sustainable well-functioning consumer credit market will still involve some consumer harm. This is because even the most creditworthy group of customers will see some borrowers default or struggle to repay. This is a feature of lending that even the most sophisticated and selective lender cannot eliminate. Assessments of credit risk are generally fairly accurate in predicting the proportion of a group of customers with the same characteristics that can be expected to default. However, they are less able to predict which individual customers within the group will fail to repay.
- 3.21** In addition, payment difficulties or default can be triggered by random life events such as sudden loss of a job, serious illness or loss of a partner.
- 3.22** Within the overall consumer credit market, there are a range of products with different product features and target markets. Given this variety, it is possible for a specific product type, or a particular business model, to become unsustainable.
- 3.23** In some cases this will simply lead to the firm, or firms, being unable to continue trading and selling their loan book, in which case the market effectively deals with the issue. However, on other occasions a business model may emerge which is economically sustainable for the lender, at least in the short term, but which poses a significant risk of harm to its customers and so requires regulatory attention.
- 3.24** This could be due, for example, to high-risk lending practices, products generating significant revenue from hidden or opaque fees and charges, or poor business practices when recovering debts. There may be particular risks in high-cost credit markets where customers may be non-prime or vulnerable, and so more susceptible to exploitation. Such customers are also likely to have fewer credit options.
- 3.25** At the level of the consumer credit market as a whole, or within specific sub-sectors, a situation could develop where the market is broadly sustainable but is vulnerable to demand or supply-side shocks. For example, an economic shock affecting borrowers' income or expenditure could trigger a default rate high enough to cause insolvencies

among firms on a significant scale. This could have a knock-on effect on the availability of credit and the economic activity funded by borrowing. This is a particular risk in relation to customers with low or variable income, where a relatively small change could have a significant impact on their ability to repay credit affordably. There may also be risks from interest rate rises, particularly for mortgage customers where an increase in mortgage repayments could affect credit affordability.

- 3.26** The wider effects of such events will generally depend on the cause of the disruption, the distribution of liabilities across lenders and their capital positions, and the scale of the affected lending relative to the firms' other activities.

Our approach to promoting a sustainable market

- 3.27** When discharging our general functions we act in a way which, so far as possible, advances one or more of our three operational objectives: to secure appropriate protection for consumers, to promote effective competition in consumers' interests and to protect and enhance the integrity of the UK financial system.
- 3.28** At a general level, we aim to ensure that customers are given the information they need to make informed decisions when shopping around, buying products or switching. As most customers borrow without difficulty, we give particular attention to areas where customers' and firms' interests are not well aligned, or where there are particular risks from specific business models.
- 3.29** We are more likely to intervene where firms' practices or market risks affect customers who are particularly vulnerable, less likely to benefit from competition for their custom or who may experience significant harm.
- 3.30** Generally, the aim of our policy interventions is to change incentives for firms in areas where it may be profitable for them to treat customers unfairly. This works alongside our supervision and enforcement approaches, which deter firms from not complying with our rules as they can face financial penalties and redress bills.
- 3.31** Our focus is primarily on firm conduct at the customer level, while the Bank, PRA and FPC are concerned with prudential and macro-economic risks and financial stability. We have complementary but distinct powers. If needed, the appropriate intervention will depend on the circumstances. We give a summary of the respective roles of the regulatory bodies below.



The regulatory framework

The FCA forms one part of the 'twin peaks' model of financial regulation, with the Bank – including the PRA – forming the other.

We work closely together, particularly where we jointly regulate firms. The FCA Chief Executive sits on the FPC and the Prudential Regulation Committee, with the Bank's Deputy Governor for Prudential Regulation sitting as a non-executive director on the FCA Board.

The Bank plays a key role in setting monetary policy and maintaining financial stability, and the PRA has a statutory objective to promote the safety and soundness of the firms it regulates (which include banks and building societies who are consumer credit lenders).

The FPC (an independent committee at the Bank) works to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system.

Examples of FCA intervention in consumer credit

- 3.32** To illustrate our approach, we give some examples below of interventions we have already made in the consumer credit market.
- 3.33** One area where we acted at an early stage to address firms' incentives was the HCSTC sector. In particular, we were concerned by the risks to customers from firms' ability to take repayment by continuous payment authority and to 'roll over' loans. By repeatedly attempting to take payment on customers' paydays – in some cases hundreds of times – firms could collect their debts as soon as the customer had been paid. This gave firms an incentive to lend to people who could not realistically afford the loan, and who could subsequently become dependent on repeat borrowing. We limited the number of attempts to take payment and the number of times a loan could be refinanced to two, which significantly reduced firms' incentives to lend to these customers.¹⁷
- 3.34** Credit card firms may have few incentives to intervene with customers in persistent debt who are keeping up with their contractual requirements as they tend to be profitable. In our April consultation paper¹⁸ we proposed new rules on persistent debt with the aim of re-balancing incentives. While many people in persistent credit card debt are not in financial difficulties and could afford to make faster repayments, a sizeable minority may not be able to do so and may be incurring significant costs. Our proposal is that, after three years of a customer being in persistent debt, a firm would be required to help the customer repay the balance on their card more quickly.
- 3.35** More generally, firms may have a commercial incentive to encourage customers to prioritise repayments over other spending. This may lead firms to take an aggressive approach to charging fees or inappropriate debt collection tactics. To address this, our rules require firms to treat customers in default or arrears with appropriate forbearance

¹⁷ See in particular PS14/3 Detailed rules for the FCA regime for consumer credit (February 2014).

¹⁸ CP17/10 Credit card market study: consultation on persistent debt and earlier intervention remedies (April 2017) – www.fca.org.uk/media/cp17-10-proposed-package-remedies

and due consideration, to only take certain formal steps once more proportionate steps have been considered and not to threaten action they cannot legally take.¹⁹

- 3.36** As well as policy interventions, we undertake thematic reviews where there are cross-cutting supervisory issues. Recent examples in consumer credit include early arrears management²⁰ and staff incentives and remuneration.²¹ In the latter, we are proposing a new rule, guidance and non-Handbook guidance to address our concerns. We also undertake multi-firm and other targeted supervisory work where necessary, for example, in the rent-to-own sector.²²
- 3.37** Our Sector Views, published alongside our 2017/18 Business Plan, set out some of the key drivers of risk in the consumer credit market and highlight our priority areas going forward.²³ These include firms' business models and lending practices, treatment of customers in financial difficulty and concerns about restricted access to products and services. We are also undertaking work in the motor finance market.²⁴

Creditworthiness including affordability

- 3.38** The rest of this consultation focuses on our approach to creditworthiness. This is a key element of ensuring a sustainable well-functioning consumer credit market.
- 3.39** Effective creditworthiness assessment helps avoid harm by denying credit to those most likely to be financially distressed. The reverse is also true – well-applied policies should also mean consumers can get credit in appropriate circumstances. We want to minimise the risk of predictable financial distress while at the same time avoiding unduly restricting access or increasing costs of borrowing.
- 3.40** Our rules require firms to consider both credit risk to the lender and affordability for the borrower. While lenders have strong commercial incentives to assess credit risk, including the probability of default, the incentives to satisfy themselves on affordability are weaker. There is therefore a particular need for regulatory requirements.
- 3.41** In an ideal world, customers would be granted credit only if they can afford to repay in a sustainable manner – without undue difficulties, while meeting other reasonable commitments and without any harm to their overall financial situation.
- 3.42** In practice, this can never be guaranteed. Affordability assessment is not an exact science. A loan may be affordable for one borrower but unaffordable for another in a similar situation because of how the individuals manage their finances. In addition, things may happen that make an initially affordable loan unaffordable – for example, because of a change of circumstances. Not all of this can be predicted in advance, and the costs of seeking to do so may be disproportionate or may unduly restrict the availability of credit for those who are likely to be able to afford it.

19 See CONC 7: Arrears, default and recovery (including repossessions).

20 TR16/10 Thematic Review: Early arrears management in unsecured lending (December 2016).

21 CP17/20 Staff incentives, remuneration and performance management in consumer credit – www.fca.org.uk/publication/consultation/cp17-20.pdf

22 www.fca.org.uk/firms/rent-own

23 Sector Views 2017 – www.fca.org.uk/publication/corporate/sector-views-2017.pdf

24 See Chapter 6 below.



- 3.43** Unaffordable debt may also result from customers finding it difficult to evaluate the uncertain costs and benefits of borrowing, or because they are less financially sophisticated and so may struggle to make informed choices. Lenders may also have limited information from which to assess affordability. These various issues are discussed further in OP 28.
- 3.44** Our aim is to reduce the risk of borrowers suffering financial distress because of something the firm could have reasonably foreseen at the assessment stage. At the same time, we want to avoid customers being unnecessarily denied or priced-out of credit because of excessive or unnecessary processes.
- 3.45** Therefore, our current and proposed rules give firms flexibility to make a reasonable assessment in each individual case, as long as they can demonstrate the basis for their decisions if challenged. We recognise that firms adopt a wide range of different processes, with varying degrees of automation, and do not wish to discourage innovative processes that may deliver good outcomes for customers. At the same time, our proposed rules are non-prescriptive about the processes which firms may adopt and so would also allow firms to undertake processing on a manual basis.
- 3.46** Being unduly prescriptive could have a number of negative consequences. In particular, it could lead firms to limit lending unnecessarily and exclude customers who could afford to repay. It could increase the cost of providing credit, so raising prices. It could also slow down the process of granting credit which could deter some applicants or lead them to switch to firms with a less thorough approach. It could cause some firms to exit the market, or to switch to longer-term loans – with lower instalments but higher overall cost – or other less appropriate forms of credit.
- 3.47** Greater prescription could also lead to a ‘box-ticking’ approach rather than a proper assessment of the individual customer’s affordability. Firms may gather data because they feel it is expected but fail to use the data adequately.
- 3.48** A more rigorous assessment may be needed, for example, where repayments are high relative to the borrower’s income, or where income or expenditure are likely to fluctuate significantly. On the other hand, if the costs and risks are low, the firm may be able to satisfy itself on affordability without undertaking detailed checks.

4 Our creditworthiness assessment rules

- 4.1** In this chapter we explain the background to our current rules on creditworthiness assessment and the key principles underpinning them. We also summarise our research on understanding how our rules and guidance are being interpreted by firms and whether they should be changed.

Background

- 4.2** We took over the regulation of consumer credit in April 2014 from the Office of Fair Trading (OFT). As part of the transfer of regulation, parts of the Consumer Credit Act 1974 (CCA) were repealed and replaced by FCA rules in our Consumer Credit sourcebook (CONC). We also made rules and guidance to replace OFT guidance.
- 4.3** Section 55B of the CCA implemented Article 8 of the CCD.²⁵ This requires EU Member States to ensure that lenders assess the borrower's creditworthiness, using sufficient information, before they make a credit agreement or significantly increase the amount of credit. The CCD makes clear that this is a key element of responsible lending, but that consumers should also act with prudence. Member States' authorities may give appropriate instructions and guidelines to lenders.²⁶
- 4.4** The CCA provisions were supplemented by the OFT's Irresponsible Lending guidance. This emphasised that a creditworthiness assessment should include an assessment of affordability for the borrower, and particularly the potential for the credit commitment to negatively affect the borrower's financial situation.²⁷

The CONC requirements

- 4.5** The creditworthiness assessment regime in CONC is largely principles-based rather than prescriptive. There are some high-level rules, but most of the detail is in supporting guidance which illustrates ways in which firms can comply with these and with our high-level principles, including treating customers fairly. Most of the provisions were carried across from the CCA and OFT guidance, on a 'lift and shift' basis.²⁸
- 4.6** With a few exceptions, the rules apply to all regulated credit agreements²⁹, but tailored where necessary – for example, in relation to open-end agreements.³⁰ This allows firms to take consistent approaches, while taking account of the circumstances of each lending decision including the type of product and customer.

25 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC.

26 Recital 26 – http://ec.europa.eu/consumers/financial_services/consumer_credit_directive/index_en.htm

27 Irresponsible lending – OFT guidance for creditors (OFT 1107), March 2010 (updated February 2011).

28 PS14/3 Detailed rules for the FCA regime for consumer credit (February 2014).

29 A regulated credit agreement is a credit agreement with an 'individual' (this includes some lending to small businesses but not companies or if the credit exceeds £25,000), unless a relevant exemption applies.

30 An open-end agreement is a credit agreement with no fixed duration.



- 4.7** Lenders are required to assess creditworthiness, on the basis of sufficient information, before entering into a regulated credit agreement or significantly increasing the amount of credit or the credit limit. This is in line with the CCD. There are also requirements on peer-to-peer (P2P) platforms to assess the borrower's creditworthiness.³¹
- 4.8** Accompanying guidance makes clear that the extent and scope of an assessment, and the types and sources of information to be used, should depend upon, and be proportionate to, relevant factors. Firms should consider what is appropriate, particularly against the cost and risk to the individual borrower.
- 4.9** In carrying out the assessment, the firm must consider:
- the potential for the commitments under the agreement to negatively affect the customer's financial situation, and
 - the customer's ability to make repayments as they fall due or, in the case of an open-end agreement, within a reasonable period
- 4.10** Firms must establish and implement clear and effective policies and procedures to make a reasonable creditworthiness assessment. We also expect firms to monitor their effectiveness, to ensure appropriate outcomes for customers.
- 4.11** There are separate requirements on policies and procedures for dealing with customers in arrears or default. These help mitigate the risks of unaffordable lending but do not remove the need for an adequate upfront assessment of affordability.
- 4.12** We published a 'common misunderstandings' document on creditworthiness and affordability in June 2015.³² However, feedback from firms and our supervisory experience suggest there is still some uncertainty about our regulatory expectations, particularly how far we expect firms to go in assessing affordability and what procedures should underpin this. As a result, some firms may not be doing enough, while others may be doing more than is required or necessary in the circumstances.

Our research – how do firms assess creditworthiness?

- 4.13** As announced in our 2015/16 Business Plan, we have undertaken research to better understand how firms currently assess creditworthiness, including affordability.
- 4.14** This has principally involved a firm survey, and earlier qualitative research. We are grateful to all the firms that participated in the research, and recognise their significant commitment in responding to detailed interviews and questionnaires. We have also looked at credit cards, HCSTC lending and ONS Wealth & Assets Survey data.

31 These apply to P2P agreements (as defined) where the borrower is an individual and the credit either does not exceed £25,000 or is not wholly or predominantly for business purposes. The requirements apply to P2P platforms, rather than investors, but the latter may be subject to our more general requirements where they are lending by way of business.

32 Creditworthiness and affordability in consumer credit: common misunderstandings (June 2015) – www.fca.org.uk/firms/creditworthiness-and-affordability-common-misunderstandings

- 4.15** We give a summary of the research findings below, and have separately published more detailed extracts of the research alongside this consultation.³³
- 4.16** We are not publishing the full survey results because of confidentiality restrictions. Firms may, however, find the extracts useful in illustrating the different types of assessment that are currently used, including the different sources of information and how these can be factored into an assessment. Sources of information used in creditworthiness assessments are also discussed further in OP 28.

Firm survey

- 4.17** We commissioned Critical Research (with John Leston) to carry out a firm survey. This involved interviews with 70 firms across 12 credit sectors, based on an extensive pre-interview questionnaire. The main fieldwork was in February to April 2016, with a final report containing anonymised results in August 2016.
- 4.18** The firms interviewed were 21 motor finance providers, 12 personal loan providers, 8 guarantor lenders, 6 logbook lenders, 5 rent-to-own providers, 4 HCSTC lenders, 4 catalogue lenders, 3 other retail credit providers, 3 home collected credit lenders, 2 P2P platforms, 1 store card provider and 1 premium finance provider. There was a mix of larger and smaller firms, with 9 having consumer credit lending income below £0.5m (12 below £1m) and 14 above £100m.
- 4.19** The firm survey did not cover credit cards as we were already collecting data through the credit card market study. It also did not cover overdrafts because of the Competition and Markets Authority's market investigation into retail banking.
- 4.20** Key findings include:
- 96% of the firms use CRAs (40% also use other external sources). 48% use two or three CRAs, and 54% use three or more CRA products.
 - 74% of firms always take account of individual income, but 10% (mainly larger firms) never do so and 7% only in marginal cases. 17% always or usually take account of household income (7% never take account of either).
 - Of those taking income into account, 74% verify it always or usually (but 3% never and 8% only in marginal cases). 87% of the firms use bank statements, 82% payslips and 42% CRA information; 48% may contact the employer.
 - 69% of firms always take account of individual expenditure, and 36% household expenditure, but 6% never take account of either and 9% only in marginal cases.
 - Of those taking expenditure into account, 41% verify it always or usually (but 17% never and 17% only in marginal cases). 80% of the firms use bank statements, 62% CRA information and 44% current account data.
 - 81% of firms use information about employment status (56% of these verify), 76% residential status (53% verify) and 43% dependants (20% verify).

33 www.fca.org.uk/publication/consultation/cp17-26-research-findings.pdf



- 96% of firms have policy rules or 'hard stops' where they will not lend. These include income source (74% of firms), income amount (44%) and employment status (53%). 39% of firms have policy rules on current indebtedness, 36% other credit commitments, 29% CRA scores and 17% loan-to-income ratio. 34% have policy rules on applicants on benefits and 44% will not lend to the unemployed.
- Firms were asked which factors are extremely or very important in the assessment and scorecards. 90% said other credit commitments, 66% disposable income, 63% loan amount, 63% previous dealings, 60% current indebtedness, 47% total income and 46% employment status.
- 96% of firms monitor the effectiveness of their assessments, with 91% doing so regularly and 50% in response to events, such as rates of delinquency/arrears or default. 45% monitor both regularly and in response to events. On average, monitoring leads to changes in assessment practices every 13 months.

4.21 Given the small sample sizes, the findings should be treated as indicative only, and may not be representative of the market. They may also not necessarily evidence non-compliance by firms. For example, a firm may not take income into account directly, but may do so indirectly as part of CRA data or products. Similarly, a firm may monitor the effectiveness of its assessments but not as part of a formal process which is documented separately.

Qualitative research

4.22 The firm survey was largely quantitative, but informed by and built on earlier qualitative research with 27 firms across 7 sectors. This was conducted by The Development Team Ltd (TDT) between October 2014 and March 2015, again on an anonymised basis. The firms comprised 6 personal loan providers, 6 credit card providers, 5 HCSTC lenders, 3 guarantor lenders, 3 P2P platforms, 2 home collected credit lenders and 2 pawnbrokers. The firms were identified by the FCA and reflected a spread of size, channel usage, products, trading history and customer profiles.

4.23 The findings showed a wide variety of behaviour, both between and within sectors. A key factor leading to differences in firms' attitudes to creditworthiness assessment, and their practices, is whether their target market is mainly prime or non-prime. Also relevant are product type and duration, amount of credit, application channel and firm resources and how long the firm has been established. There are significant differences in the extent that firms use automated or manual decision-making, the types of information or data they use and the extent to which they verify these.

4.24 In general, firms serving a prime market tend to rely on CRA data for credit risk, and may be uncertain how much resource to commit to affordability assessment. They are concerned that trying to measure affordability through income and expenditure assessments can be expensive and result in intrusive and lengthy processes for customers, leading to fewer applications. It can also require resource-intensive manual underwriting when the firm's overall aim is for more automated processes.

4.25 In contrast, firms serving non-prime markets cannot rely to the same extent on CRA data, particularly where customers have 'thin' credit files, and so assessing affordability becomes more important. These firms have a strong incentive to invest in affordability

assessment even if that involves manual data capture and underwriting, but they value the flexibility of the current CONC rules. Some are unsure how far they are expected to document processes and criteria in order to demonstrate compliance.

- 4.26** The main conclusions suggest that most firms believe they are compliant with CONC requirements but are looking for reassurance on this and more generally would welcome greater clarity about our expectations.

Credit cards

- 4.27** Our market study analysis showed that credit card firm processes are highly automated and data-driven, relying significantly on CRA data and products.³⁴
- 4.28** There is a relatively high degree of similarity of approach between firms. Differences tend to be based on the size of a firm and whether it is a bank with access to current account data. Credit card firms focus primarily on credit risk but have introduced affordability metrics, including indebtedness scores.

High-cost short-term credit

- 4.29** Another research element analysed how changes in creditworthiness assessments by HCSTC lenders related to customer outcomes. This involved collecting transaction-level data from lenders and matching these to detailed CRA data, including metrics assessing credit risk and affordability.
- 4.30** The analysis found a wide variety in the ways that HCSTC lenders assess creditworthiness, and that processes changed during 2014/15 in response to regulatory and market changes. The most common changes were to credit risk score thresholds or limiting lending based on the value of outstanding debts or loan size relative to income.
- 4.31** The analysis tried to isolate the effects of changes in assessments on the resulting outcomes for customers but was unable to reliably conclude which specific types of change had the most impact.
- 4.32** In addition, the research assessed the relationship between credit risk and measures used by HCSTC lenders to predict the likelihood of financial distress. The results are published in OP 28 which accompanies this CP.³⁵

34 [MS16/6.2 Credit card market study: interim report \(November 2015\), Annex 5 – www.fca.org.uk/publication/market-studies/ms14-6-2-ccms-interim-report.pdf](http://www.fca.org.uk/publication/market-studies/ms14-6-2-ccms-interim-report.pdf)

35 www.fca.org.uk/publication/occasional-papers/op17-28.pdf



Wealth & Assets Survey

- 4.33** An earlier OP³⁶ undertook statistical analysis of the Wealth & Assets Survey (WAS) published by the Office for National Statistics (ONS).
- 4.34** This looked at the distribution of consumer credit debts among adults in Great Britain, estimated the scale of financial distress and how this relates to measures of wellbeing and analysed whether financial distress can be predicted. The data were derived from wave 4 of the WAS which were collected between 2012 and 2014.
- 4.35** In particular, the research found:
- 61% of adults had at least one consumer credit product, and at any time roughly one in four individuals (26%) held outstanding consumer credit debt.³⁷
 - Ordering individuals by their DTI ratio showed that the top 10% of individuals had debt levels above 38% of gross individual income before tax.
 - Using a narrow definition of financial distress based on arrears, 2% of individuals with outstanding consumer credit debt were in financial distress.
 - Using a broader measure of financial distress which combined objective and subjective measures,³⁸ around 17% of individuals with outstanding consumer credit debt, or 7% of those with a consumer credit product (2.2 million people), were in moderate or severe financial distress.
 - Compared to other individuals, those in financial distress were typically younger, with lower incomes and higher DTI ratios. They also had noticeably worse self-reported measures of wellbeing.
 - DTI appeared to be a statistically strong predictor of future financial distress, even after controlling for 'life events' such as becoming unemployed. The top 10% of individuals by DTI ratio were much more likely to suffer financial distress.

36 OP 20 Can we predict which consumer credit users will suffer financial distress? (August 2016) – www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf

37 This excludes mortgages, student loans and other household debts. In addition, outstanding debt does not include credit card transactions paid off at the next statement.

38 This measure was constructed from individuals who were two or more payments in arrears on at least one credit product or regarded their debts as a heavy burden or were falling behind on some or many financial commitments.

5 Proposed changes

- 5.1** In this chapter we set out our proposed changes to the CONC rules and guidance on creditworthiness assessments. These are largely intended to clarify our expectations and so make it easier for firms to comply.
- 5.2** As part of this, we are restructuring the relevant provisions to make them easier for firms to follow. We are also proposing some new rules and to convert some existing CONC guidance into rules, as set out below.

Summary of proposed changes

- 5.3** The following table summarises the main proposed changes:

Table 2: Summary of changes

Existing CONC provision	Proposed changes
CONC 5.2 and 5.3 and CONC 6.2	Combined in a new CONC 5.2A, covering both the initial assessment by lenders and post-contractual credit increases (5.2A.4R)
CONC 5.2.1R	Minor changes to scope of creditworthiness rules (5.2A.2R); clarifying that creditworthiness comprises credit risk and affordability (5.2A.9R); elaborating on the meaning of affordability (5.2A.10R)
CONC 5.2.2R	Single test of creditworthiness (5.2A.4R) applying to all relevant agreements with some limited exceptions (5.2A.2R)
CONC 5.2.2R, 5.2.3G and 5.2.4G	Clarifying the meaning of proportionality and the factors to be taken into account by firms when deciding on the extent and scope of an assessment and the types and sources of information to use or verify (5.2A.19R to 5.2A.23G)
CONC 5.2.5R and 5.2.6G	Clarifying the obligation to assess potential impacts on a guarantor (5.2A.31R and 5.2A.32G)
CONC 5.3.1G	Clarifying the meaning of affordability (5.2A.10R) and the role of income and expenditure information (5.2A.13R to 5.2A.18G); clarifying that income for these purposes must be the customer's own (5.2A.14R); elaborating on the assumptions to be used for open-end agreements and running-account credit (5.2A.24R to 5.2A.28G)
CONC 5.3.2R and 5.3.3G ⁴¹	Elaboration of requirements relating to firms' policies and procedures for creditworthiness assessments (5.2A.33R and 5.2A.34G); clarifying expectations in relation to verification of information (5.2A.21 and 22G)
CONC 5.3.4R	Pawnbroking carve-out becomes an exception where certain conditions apply (5.2A.2R)
CONC 5.5	Moved to new CONC 5.5A covering assessments by P2P platforms (to parallel requirements on lenders); expanded to include post-contract credit increases under P2P agreements (5.5A.5R)

39 See also SYSC 4.1.1R, 4.1.2R, 4.1.4R, 4.3.1R, 4.3.2R, 6.1.1R, 6.1.2R, 9.1.1R, 9.1.4G and 9.1.5G.



Scope of regime

- 5.4** First, we propose some minor technical changes to the scope of the creditworthiness rules, including correcting some anomalies that arose when regulation was transferred to the FCA. This should make it easier for firms to understand and apply the requirements.
- 5.5** With a few exceptions, the current CONC provisions apply to all regulated credit agreements. However, certain types of agreement, instead of being subject to the creditworthiness rules, are subject to a parallel obligation to assess the potential for the credit commitments to negatively affect the customer's financial situation. Most of the remainder of CONC 5 applies regardless of which specific obligation applies to the particular agreement.
- 5.6** We think this is unnecessarily complex and potentially confusing. Therefore, we propose to apply a single creditworthiness requirement.
- 5.7** We propose to exclude non-commercial agreements⁴⁰ and small borrower-lender-supplier agreements for restricted-use credit.⁴¹ These agreements were previously excluded from the scope of section 55B CCA⁴² and including them within the CONC creditworthiness regime was an oversight.⁴³
- 5.8** As currently, the rules will apply to authorised overdraft agreements, but not to overrunning (unarranged overdrafts). This is in line with the CCD. We are considering unarranged overdrafts more generally as part of our high-cost credit review.
- 5.9** We propose to apply the rules without limitation to agreements that finance payments arising on, or connected with, a person's death.⁴⁴ Currently the CONC rules apply only in particular circumstances, but this is an oversight and contrary to the previous CCA position.⁴⁵ For the same reason, we propose to delete CONC 4.2.5R (8) and (9), and to make a determination under section 74(3) CCA in similar terms to the previous OFT determination, to apply section 74(1)(c).⁴⁶ Again, this corrects an oversight. The proposed determination is included as an appendix to this consultation paper.
- 5.10** Pawnbroking agreements are currently subject to the parallel obligation referred to above. However, a firm is entitled to base the assessment primarily or solely on the value of the security where the agreement limits the customer's total financial liability to the proceeds of sale which would represent the true market value of the article within the meaning of section 121 CCA.
- 5.11** Again, we think this is unnecessarily complex and potentially confusing. So we propose to convert this into an exclusion from the new CONC 5.2A. If the exclusion does not apply, for example, because the customer may be liable for sale expenses if the item

40 A non-commercial agreement is one where the lender is not acting in the course of business.

41 A small agreement is one where the amount of credit does not exceed £50, and the agreement is not a hire-purchase or conditional sale agreement – section 17 CCA.

42 Section 74(1) CCA – section 55B was not applied by section 74(1A) or (2).

43 If the agreement is a P2P agreement (entered into via a peer-to-peer platform), the platform will be separately required to undertake a creditworthiness assessment under CONC 5.5A.

44 Where such agreements relate to inheritance tax or certain court fees (for example, in relation to an application for a grant of probate) or related matters, and the lender is a bank.

45 Section 55B (and section 55A) applied to such agreements without limitation.

46 Section 74(3) CCA applied section 74(1)(c) only where the OFT so determined. The Financial Services Act 2012 (Consumer Credit) Order 2013, SI 2013/1882, amended section 74(3) by substituting 'FCA' for 'OFT' and so enabled the FCA to make a determination to replace the OFT determination. However, this was not done.

is sold by the firm that might take the customer's total liability beyond the true market value of the item, the normal creditworthiness rules will apply.

5.12 We propose transitional provisions to allow firms to make creditworthiness assessments under existing CONC rules where an application process has started when the new rules come into force. This is conditional on the relevant agreement or significant increase in credit being completed within one month.

Q1: Do you agree with our proposed changes to the scope of the creditworthiness rules and proposed transitional arrangements?

Assessing creditworthiness

5.13 As under the current regime, the firm must make a reasonable assessment of the customer's creditworthiness before making a regulated credit agreement or significantly increasing the amount of credit or the credit limit. The assessment must be based on sufficient information – from the customer where appropriate, and from a credit reference agency (CRA) where necessary.

5.14 This mirrors the position under the CCD.

5.15 We do not propose to prescribe exactly when an increase is significant. This will depend on the circumstances and should usually be obvious. However, we are making clear that a significant increase can be made up of a number of separate increases which, while insignificant individually, may collectively be significant in terms of affordability, triggering a further assessment.

5.16 The types of information necessary in any particular assessment will depend upon all the circumstances including the nature of the product and customer, and proportionality. The onus will be on the firm to ensure that the information considered is sufficient to enable it to make a reasonable assessment.

Meaning of affordability

5.17 We propose to clarify that creditworthiness includes both credit risk to the lender and affordability for the borrower. The latter is key in consumer protection terms while the former may have prudential implications.

5.18 There is reference to affordability in the heading of CONC 5.3 but it is otherwise implicit in the current provisions. We think it is important to make it explicit.

5.19 We propose to require firms to consider affordability in terms of the risk to the customer of not being able to make repayments:

- as they fall due over the life of the credit agreement, and within a reasonable period in the case of an open-end agreement



- wholly out of income, unless the customer has clearly indicated an intention to repay using savings or other assets
- without the customer having to borrow to meet the repayments, or being unable to meet other financial commitments, and
- without the repayments having a significant negative impact on the customer's overall financial situation

5.20 This combines elements of existing CONC provisions which refer to being able to make repayments in a sustainable manner, without the customer incurring financial difficulties or experiencing significant adverse consequences. However, we think setting out the provisions as a single rule in this way will make it easier for firms to understand what we expect of them in assessing affordability.

5.21 The proposal makes clear that repayment should normally be out of income. Where a customer intends to repay using savings or assets, the firm will be required to take into account the purpose of the savings or assets, the likelihood that they will be available for repayment of the credit and any significant negative impact on the customer's financial situation of using those savings or assets. An example might be a wealthy individual, urgently in need of short-term cash, borrowing with a view to repaying from other readily realisable assets.

5.22 We propose to clarify that income for these purposes must be the customer's own. This can include income from jointly-held savings or assets where this can reasonably be expected to be available to the borrower for repaying the credit. However, when assessing affordability, the firm must not take into account the income of any other person, such as another household member.⁴⁷

5.23 In the case of joint borrowers, the firm should assess whether to consider income separately for each customer (as well as together), taking into account the risk to that customer if they were to become solely responsible for repaying the credit.

5.24 We propose changes to the Glossary terms 'sustainable debt' and 'unsustainable debt' which are used in CONC 6.7 (refinancing) and elsewhere in CONC, but which are not used for the purposes of the creditworthiness proposals.

Q2: Do you agree with our approach to the meaning of affordability and the factors that should be taken into account by firms?

Income and expenditure

5.25 In the majority of cases where the customer is 'prime'⁴⁸ and the amount and cost of the credit are relatively low, the firm may be able to satisfy itself on affordability without considering or verifying the customer's income and expenditure.

⁴⁷ In the case of a guarantor loan, a separate assessment is required in relation to the guarantor but this is independent of the requirement to assess affordability in respect of the borrower.

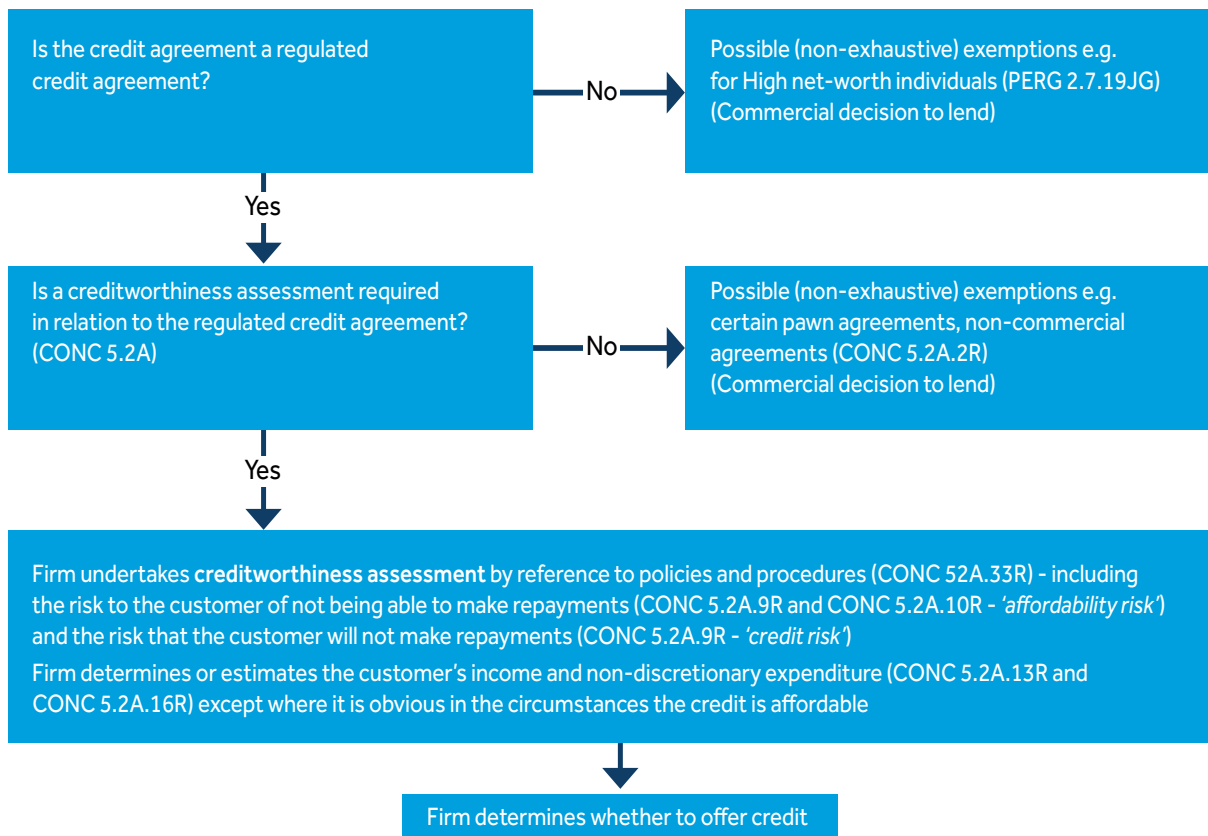
⁴⁸ 'Prime' customers are generally recognised as those with a good credit history and no financial difficulties.

- 5.26** For example, this may be clear on the basis of a CRA check or other information. Alternatively, having established that the customer is in a particular employment, which is known to generate a minimum income, it may be self-evident that the loan is affordable, given the amount of the monthly instalments and the total amount payable.
- 5.27** So we propose to make clear in the rules that a firm does not need to estimate or establish the customer's income (or disposable income) where it can demonstrate that it is obvious in the particular circumstances that the credit is affordable. This may be the case, for example, where a relatively small amount of credit is offered to a customer who shows no signs of financial difficulties and in relation to whom no adverse information is apparent from the application or a CRA check. In such a case the costs and risks of the credit are likely to be low, and so the risk of predictable financial distress is low.
- 5.28** Where this is not the case, or the firm is unable to demonstrate it, the firm will be required to take income into account in some way in the assessment.
- 5.29** This will not necessarily involve establishing the amount of the customer's income, or asking the customer for details or documentation. Instead, it may be sufficient to rely on an estimate – for example, based on employment status, or using CRA information based on previous application data or current account turnover. Whether this is appropriate will depend on the particular circumstances, including the costs, amount and risks of the credit in the individual case. The firm would need to be able to demonstrate, if challenged, that it made a reasonable assessment in the circumstances.
- 5.30** However, it will not generally be sufficient to rely solely on a borrower's statement of income. As under the current CONC provisions, more is likely to be needed such as a CRA check or documentation. We recognise that there may be individual cases where self-certification of income may be sufficient, given the costs and risks to the individual borrower, but the firm would need to be able to substantiate this.
- 5.31** Where the firm takes income into account, it must consider any likely material reduction in income during the period of the credit, where reasonably foreseeable. For example, this could be because of a likely change in the customer's employment status or hours worked, or because the customer is approaching retirement.
- 5.32** Where a firm is required to establish or estimate income, it must also establish or estimate non-discretionary expenditure (i.e. disposable income) – unless it is obvious in the particular case that this is unlikely to have a material effect on affordability.
- 5.33** For example, in a case where an applicant is seeking a relatively small amount of credit it may be clear from assessing income that there is likely to be a sufficient 'buffer' to allow for affordable repayment of the credit, regardless of the level of the customer's non-discretionary expenditure. This may also be clear from a CRA check which considers, for example, indebtedness indicators or ONS data. As above, the onus would be on the firm to be able to demonstrate this in the particular circumstances.
- 5.34** We make a distinction between discretionary and non-discretionary expenditure. Cutting back on discretionary spending may not affect the customer badly. However, a failure to meet existing financial commitments, for example, has more significant implications.



- 5.35** Non-discretionary expenditure includes payments to meet priority debts or which the customer has a statutory or contractual obligation to make, for example, under another credit agreement or a mortgage. It includes spending on behalf of other individuals whose financial obligations the borrower partly or wholly meets, such as dependants.
- 5.36** As above, where a firm is required to consider non-discretionary expenditure (because affordability is not obvious without doing so), it may be disproportionate to establish an exact amount. An estimate may be sufficient, based, for example, on ONS or other statistical data for the type of borrower in question, unless the firm knows or has reasonable cause to suspect that the customer's non-discretionary expenditure is higher.
- 5.37** Where expenditure is taken into account, the firm should consider whether this is likely to increase materially over the period of the credit. For example, if the customer has a mortgage, the firm should consider whether interest rates may rise over the relevant period, increasing mortgage repayments, and whether this could have a material impact on credit affordability. This may be particularly relevant where the mortgage repayments account for a significant proportion of the customer's income.
- 5.38** The flow diagram below illustrates when the proposed rules would apply. It is not intended to suggest to firms any particular operational process.

Table 3: Overview of proposed rules



Note
This diagram illustrates the high-level requirements of our proposed creditworthiness rules. It is not intended to reflect all factors that may be relevant decisions, such as firms' profitability expectations and fraud assessment processes.

What do we mean by creditworthiness assessment?

In assessing creditworthiness, a firm must consider the risk the customer will miss one or more repayment ('credit risk') as well as the risk to the customer posed by the credit ('affordability risk'). In assessing affordability risk to a customer, a firm must consider the customer's ability to make repayments:

- as they fall due
- wholly out of the customer's income
- without the customer having to borrow to meet the repayments
- without failing to make any other payment the customer is obliged to make
- without the repayments having a significant adverse impact on the customer's financial situation

5.39 In summary, the firm needs to be satisfied in each case that the credit is likely to be affordable. In many cases this may be obvious, without having to establish income and expenditure, and even where this is necessary, an estimate may be sufficient. The extent of the affordability assessment required will depend upon issues of proportionality, including the type and amount of the credit and the costs and risks to the borrower.⁴⁹ However, the firm would need to be able to demonstrate, if challenged, that it had a reasonable basis for its view and this was based on sufficient information.

Q3: Do you agree with our proposals on the use of income and expenditure information?

Proportionality

5.40 We propose to make a rule specifying that the extent and scope of a creditworthiness assessment in a particular case – and the steps needed to ensure the assessment is reasonable – depend on, and are proportionate to, the individual circumstances.

5.41 Specifically, the firm must have regard to the following:

- the type of credit
- the amount and duration of the credit
- the frequency and amount of instalments
- the total amount payable
- the total charge for credit and the annual percentage rate of charge (APR)
- whether interest rates and charges are fixed or variable

⁴⁹ For this reason, we are not proposing detailed requirements of the kind introduced for mortgages by the Mortgage Market Review (MMR) and implementation of the Mortgage Credit Directive (MCD) which is more prescriptive in this area.



- other potential costs, including default charges or early exit costs
- other potential consequences of non-payment

- 5.42** The firm should take these into account, where relevant, when, for example, deciding on the types and sources of information to use in the assessment and whether and to what extent to verify information. These factors will also be relevant when the firm decides how the information should be factored into the creditworthiness assessment.
- 5.43** Firms should decide what is reasonable in the circumstances. For example, where credit is relatively low-cost and for small amounts, there will be cases where no verification is needed, given the costs and risks to the borrower. However, a firm should be able to demonstrate that it undertakes appropriate assessments having considered these risks.
- 5.44** A firm should also take into account information it knows at the relevant time which indicates that the customer is in, or has recently experienced, financial difficulties, or is particularly vulnerable, for example, because of a mental capacity limitation. We would not necessarily expect a firm to proactively establish whether such factors apply, as this may be disproportionate. However, it should not ignore relevant information.
- 5.45** If a firm takes account of information it obtained during previous dealings with a customer, it should consider whether this is still relevant or needs updating.
- 5.46** A firm does not need to take default charges into account directly in assessing a customer's ability to repay, as it can assume that the borrower keeps to the terms of the agreement. However, they are a potential risk to the customer, and so may be relevant in terms of the proportionality of the assessment.
- 5.47** The greater the actual or potential costs or risks of the credit in a particular case, the more rigorous the assessment should be and the greater the information that is likely to be needed to support it. On the other hand, if the costs and amount of the credit are low, for instance relative to the customer's financial situation, the firm may need to conduct a less rigorous assessment, and need less information to support it.
- 5.48** OP 28 published alongside this consultation sets out an economic framework for understanding why unaffordable consumer credit debt can occur, and how it might be prevented, and uses this framework to examine the predictability of financial distress among consumers applying for high-cost short-term credit (HCSTC). It finds that consideration of a debt-to-income (DTI) ratio in HCSTC may be a useful indicator of potential financial distress, although there may be other ways of assessing affordability.
- 5.49** We propose clarifying that the volume and content of information that must be taken into account when assessing creditworthiness will depend on the level of affordability risk. In light of the findings in OP 28 we also propose to clarify that affordability risk, and so the need for a more detailed and rigorous assessment, may be high where the total value of the customer's debts relative to the customer's income is high.
- 5.50** We also propose to clarify that where there is evidence to suggest that there is a high likelihood that the customer will be unable to make one or more repayments under the credit agreement (i.e. the customer is deemed to be a high credit risk), then this may

also be an indicator of a high level of affordability risk. Again, this may indicate that the firm should undertake a more detailed and rigorous assessment.

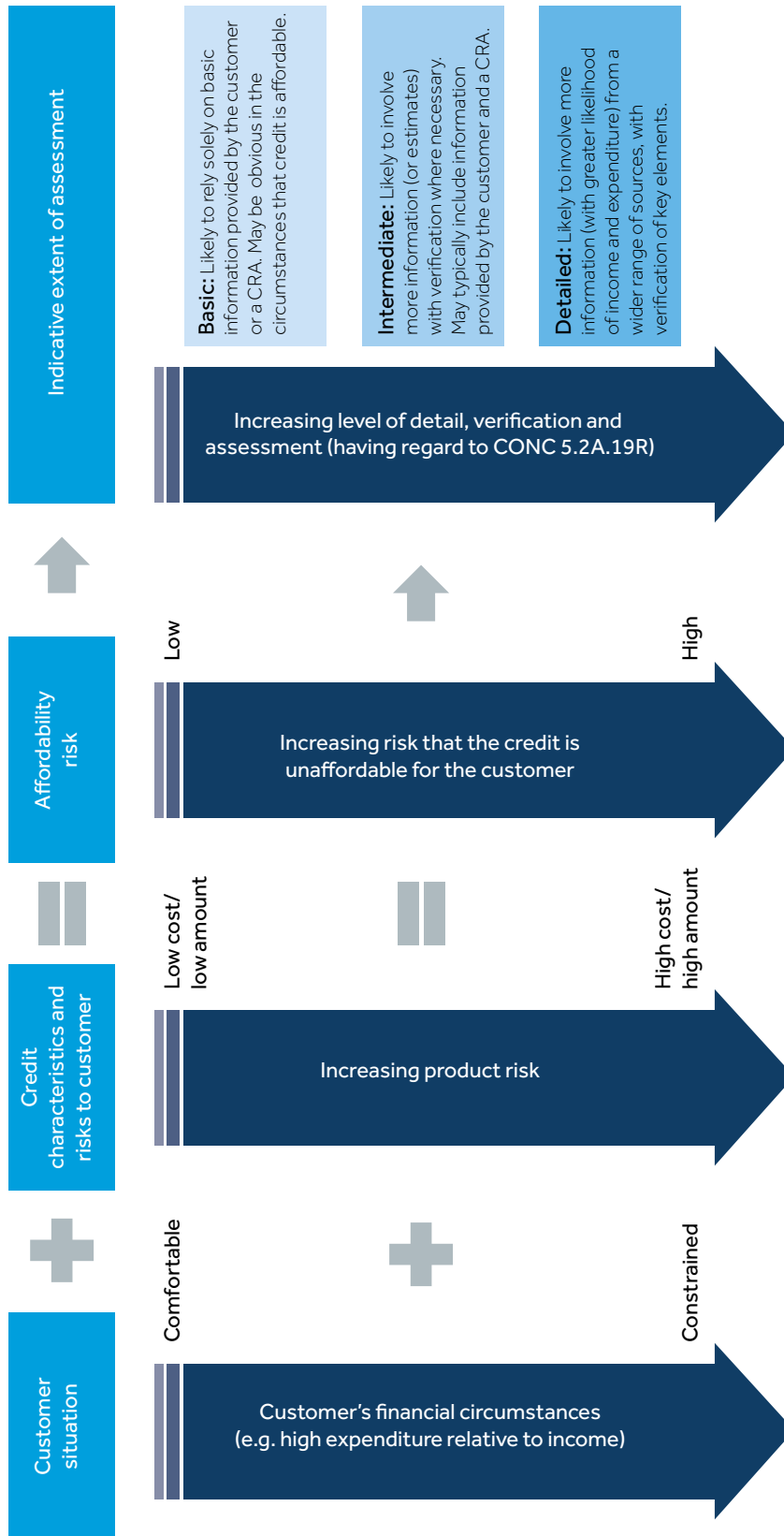
- 5.51** While OP 28 recognises the potential usefulness of DTI ratios in predicting financial distress in HCSTC, we do not think it would be appropriate to mandate the use of specific ratios, or to stipulate indicative thresholds beyond which firms should not generally lend, across the consumer credit market.
- 5.52** We consider that introducing such requirements would be unduly prescriptive and may lead to unintended consequences, given the breadth and diversity of the consumer credit market. Given the wide variety of approaches adopted by firms, both within and between sectors, there are different ways in which a firm can satisfy itself on affordability. It could also be disproportionate to have to establish income and total debts in all cases, and data limitations may create practical difficulties in doing so.
- 5.53** Moreover, an indicative DTI ratio for a particular sector may have limited relevance for another sector with different product or customer characteristics, or may become less relevant over time. It may also not take account of other significant expenditures that could have a material impact on affordability risk. We would not want firms to assume that lending to customers below a certain DTI threshold could necessarily be undertaken at lower risk with an automatically less rigorous assessment.
- 5.54** However, firms may wish to take account of the findings in OP 28 when reviewing their policies and procedures and in considering what level of assessment may be appropriate and proportionate in the circumstances.

Q4: Do you agree with the factors which we propose that firms should have regard to when considering proportionality of processes for assessing creditworthiness including affordability?

- 5.55** The infographic and tables below demonstrate how proportionality may affect the level of assessment required under our proposed rules, having regard to the particular circumstances of the customer and the characteristics of the credit. We welcome comments on these.



Table 4: Factors influencing proportionality of assessment



Note
Indicative assessments are illustrative only. Firms should consider the nature and extent of information needed for the purposes of the creditworthiness assessment (see CONC 5.2A.19R, CONC 5.2A.20G – CONC 5.2A.23G) taking into account affordability risk (CONC 5.2A.10R).

5.56 Table 5 below illustrates how the risks of the product and customer characteristics may affect the type of assessment. We would expect firms to take these into account when determining appropriate policies and procedures.

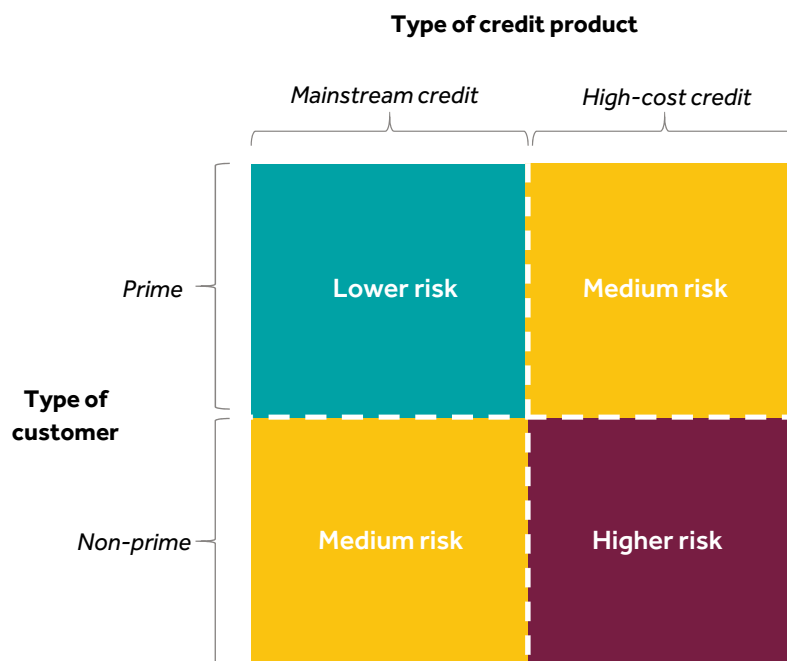
Table 5: Risks and customer characteristics

<p style="text-align: center;">Lower risk</p> <p>Where 'mainstream' credit products are offered to 'prime' customers, with no evidence of financial difficulties apparent from the application or a CRA check, and for small or moderate amounts of credit, it may be obvious that the credit is affordable without establishing or estimating income and expenditure. The firm would need to be able to demonstrate this if challenged.</p>
<p style="text-align: center;">Medium risk</p> <p>Where it may not be obvious in the circumstances that the credit is affordable, and so a more rigorous assessment is needed. This may, for example, be because of the amount or cost of the credit or the customer's existing indebtedness. The firm should consider what is appropriate and proportionate in the circumstances.</p>
<p style="text-align: center;">Higher risk</p> <p>Where non-mainstream products are offered to non-prime customers, particularly those with low or uncertain income who may be more susceptible to income or expenditure shocks, we would ordinarily expect firms' processes to reflect a more detailed assessment of affordability, with more reliance likely to be placed on income and expenditure information and verification.</p>

Note
Firms should consider what information is necessary to assess 'affordability risk' in accordance with CONC 5.2A.10R and having regard to proportionality (CONC 5.2A.19R).

5.57 This is also illustrated in Table 6 below. Given that most customers are likely to be 'prime' and to be applying for 'mainstream' credit products, we expect that most lending decisions will fall within the top left quadrant. The firm would need to decide in each case whether affordability is obvious, without establishing or estimating income (or disposable income), or whether more is needed in the circumstances.

Table 6: Indicative risks according to product and customer type





Open-end and running-account credit

- 5.58** Our proposals apply regardless of the type of credit. However, additional provisions are needed for certain types of agreement.
- 5.59** As under the existing regime, for an open-end agreement, such as a credit card, the firm should make a reasonable assumption about how long the credit is likely to be for. To improve regulatory certainty, we propose to make this a rule.
- 5.60** There is a linked provision for running-account credit, which in most cases will also be open-ended. We also propose to make this a rule. Given the importance of affordability assessment in minimising credit card debt problems, our proposals complement the proposed remedies following our credit card market study.⁵⁰
- 5.61** Specifically, we propose that when the firm assesses affordability, and sets a credit limit, it should satisfy itself on the customer's ability to repay using a number of assumptions. The firm should first assume that the customer draws down the full credit limit on day one and repays by equal instalments over a reasonable period. In determining this, the firm should consider the typical period of repayment of a fixed-sum loan for the same amount on terms likely to be available to that customer.⁵¹
- 5.62** However, it is clearly unrealistic to assume that a customer will not make further drawdowns once repayments have refreshed the available credit – but equally unrealistic to assume that the customer remains 'maxed out' indefinitely. In light of this, we propose to require firms to make reasonable assumptions about likely further drawdowns and repayments over the likely period of the credit.
- 5.63** Again, we are not mandating the assumptions firms should use. The firm may, for example, base the assumptions on typical spending and repayment behaviour of customers generally, or those with similar characteristics to the applicant. However, it should take account of any known factors specific to the individual customer.

Guarantor loans

- 5.64** In the case of guarantor loans⁵², as well as assessing the borrower's creditworthiness the firm will be required to assess the potential for the commitments under the credit agreement to have a significant negative effect on the guarantor's financial situation.
- 5.65** The assessment of the guarantor will not need to be identical to that undertaken in relation to the borrower, but it should have sufficient depth and scope, taking into account the potential obligations that might fall on the guarantor.
- 5.66** In considering this, we propose that the firm should have regard to matters applying in relation to the borrower (plus some additional matters specific to the guarantor), but that these should generally apply as guidance not rules, given that the guarantor will usually be required to pay only if the borrower does not. The firm must, however, consider sufficient information to make a reasonable assessment.

50 See Chapter 6 below.

51 This need not be the only basis for determining a reasonable period.

52 Under which an individual other than the borrower provides a guarantee or an indemnity or both.

Peer-to-peer lending

- 5.67** We propose corresponding changes to the requirements on P2P platforms, currently in CONC 5.5. These generally parallel the position for lenders.
- 5.68** These requirements are particularly important where a P2P investor is not lending by way of business⁵³ and so does not have to meet the CONC 5.2A requirements even if the P2P agreement is a regulated credit agreement. Requiring the platform to make a creditworthiness assessment ensures important borrower protections.
- 5.69** We also propose to extend the creditworthiness requirements to include a significant increase in the amount of credit or the credit limit under a P2P agreement. There is currently a gap in the regulatory regime. CONC 5.5 parallels CONC 5.2 and 5.3 for the pre-contract assessment but there is no equivalent to CONC 6.2 for post-contract assessments by P2P platforms. We propose to remedy this anomaly.
- 5.70** Where a P2P investor is lending by way of business, CONC 5.2A will apply and the platform will have parallel obligations under CONC 5.5A. However, either party will be able to outsource all or part of the creditworthiness assessment to the other, although each will remain ultimately responsible for ensuring they comply with their obligations under the regulatory regime.⁵⁴
- 5.71** We are undertaking a post-implementation review of our crowdfunding rules more generally, and may consider further CONC changes in light of this.⁵⁵

Q5: Do you agree with our proposals for open-end and running-account credit, guarantor loans and peer-to-peer loans?

Policies and procedures

- 5.72** CONC currently requires firms to establish and implement clear and effective policies and procedures to make a reasonable creditworthiness assessment.
- 5.73** We propose to clarify that the policies and procedures must be in writing, and must set out the principal factors to be taken into account in assessing creditworthiness. They must be approved by the firm's senior personnel or governing body.⁵⁶
- 5.74** We also propose additional requirements which build on existing obligations under our Senior Management Arrangements, Systems and Controls sourcebook (SYSC).
- 5.75** In particular, we propose to require firms to assess and periodically review the effectiveness of their policies and procedures for creditworthiness assessments, and the firm's compliance with both these and the relevant CONC requirements. The firm must take appropriate measures to address any deficiencies.

53 See our Perimeter Guidance (PERG), section 2.3.

54 SYSC 8 in our Senior Management Arrangements, Systems and Controls sourcebook sets out requirements relating to outsourcing of functions by regulated firms.

55 FS16/13 Interim feedback to the call for input to the post-implementation review of the FCA's crowdfunding rules (December 2016).

56 Other than in the case of a sole trader.



- 5.76** Where a firm grants credit or significantly increases the amount of credit or the credit limit, it will be required to maintain a sufficient record of the transaction to demonstrate that it carried out a creditworthiness assessment, where required, and that this was in accordance with CONC. This enables us to monitor the firm's compliance.
- 5.77** Existing SYSC 9 guidance refers to firms having appropriate systems and controls for record-keeping, and retaining records for as long as relevant for the purposes for which they are made. Although we are not requiring firms to keep a record of declined credit applications, firms may wish to do this as a way of demonstrating the effectiveness of their policies and procedures.
- 5.78** We also propose to require firms (excluding sole traders) to establish, implement and maintain robust governance arrangements and internal control mechanisms to ensure they comply with these obligations. Again, this builds on existing SYSC requirements.

Q6: Do you have any views on our proposals in relation to firms' policies and procedures for creditworthiness assessment?

Accessing and using data

- 5.79** CRAs play a significant role in providing data, products and other analytics to inform lenders' assessments of credit risk and affordability. We recognise that the system of reporting to CRAs through industry agreements has enabled the development of one of the most advanced credit reference markets in the world.
- 5.80** We regulate the activity of providing credit references. While data provision is governed by contractual relationships with lenders, and data protection legislation, CRAs must meet our high-level standards including Principle 6 – treating customers fairly. We encourage the timely and efficient sharing of credit data as we recognise the benefits to both lenders and consumers of firms having an up-to-date picture of a customer's credit history and commitments.
- 5.81** OP 28 published alongside this consultation looks at issues relating to firms' access to, and use of, CRA and other data. It notes in particular:
- CRAs have innovated by bringing new products and data sources to the market. These include monthly current account turnover data (CATO), credit risk scores, indebtedness indicators and real-time data sharing.
 - However, there are data sources that are not currently shared via CRAs, or where data sharing is limited – for example, rental payments and transaction-level personal current account data. This may particularly affect non-bank lenders, given current data sharing arrangements, although the development of open-source application programming interfaces (APIs) in banking should help.
 - Firms are not required to share data to all CRAs, and CRAs do not share data between themselves. This means that each CRA has an incomplete picture of an individual's debts, so using data from a single CRA (or just two) can under-state current debt levels and repayments and miss potentially relevant historical data.

- There were substantial differences in the total value of outstanding debts and number of credit products reported to two different CRAs for the same 1.2m individuals who had taken out a HCSTC loan – a difference of 24% or £1.6bn. This represents £1,200 of unreported debt for a typical HCSTC customer. Such differences may be expected to be smaller (or non-existent) for prime customers using mainstream products from banks and other lenders who report to all three main CRAs.
- Even if lenders collect data from all three main CRAs, they may not be able to accurately separate out credit items reported to multiple CRAs, to assess an individual's actual debts. There may be some over-stating.
- CRA data may not be up to date, despite some progress towards real-time data sharing in HCSTC. Data showing the borrower's current position, including new credit products taken out or changes to existing debts, may be one or two months behind, and so other lenders may not be aware of a new credit commitment or early arrears.
- There are differences in how firms report credit items to CRAs as each CRA has different product categorisations. As a result, not all firms report in exactly the same ways. There are also differences in arrears reporting.

5.82 We welcome views on these issues. We are particularly interested in recent or proposed developments that may improve the data and products available from CRAs or other sources to help firms make assessments of affordability and credit risk.

5.83 We would also welcome views on when it may be reasonable to rely on such data or products instead of asking the borrower for information or documentation, or as a way of verifying information, and any related issues and how these might be addressed.

5.84 We may consider further work in this area in the future.

Q7: **Do you have any views on the use of CRA data and products, or other data sources, as part of an assessment?**

Q8: **Do you have any other comments on our proposed changes to CONC in relation to creditworthiness including affordability?**



6 Next steps

- 6.1** In this chapter we set out next steps on this consultation together with a summary of other recent and current consumer credit policy work.

This consultation

- 6.2** The rules and guidance on which we are consulting are in the draft instrument at Appendix 1. The consultation closes on 31 October 2017. We will then review the responses and publish our feedback, policy decisions and final rules and guidance. We will also publish a determination along the lines set out in Appendix 2.

Other consumer credit policy work

- 6.3** We consulted in September 2016 on a proposed amendment to the CONC rules on APR calculation.⁵⁷ This involved the situation where different interest rates or charges apply for a limited period or amount. We published a Handbook notice in December 2016 and the changes came into force on 9 March 2017.⁵⁸
- 6.4** We consulted in October 2016 on revised guidance on guarantor loans and the CCA requirement to issue a default notice before enforcing security.⁵⁹ This updated an earlier consultation in February 2016⁶⁰ in light of responses we received and our further analysis of the issues. We published final guidance on 19 January 2017.⁶¹
- 6.5** We consulted in March 2017 on changes to the reporting requirements for consumer credit firms, set out in our Supervision manual (SUP).⁶² We published a Handbook notice on 23 June and the changes came into force on 1 July.⁶³

CCA retained provisions review

- 6.6** Legislation requires us to review the CCA provisions which were retained following the transfer of regulation to the FCA. We must report to the Treasury on whether their repeal would adversely affect the appropriate degree of protection for consumers and which provisions could be replaced by FCA rules or guidance.
- 6.7** This is an important opportunity to ensure that the consumer credit regime is appropriate to the needs of consumers and the market. We published a Call for Input⁶⁴

57 CP16/21 Quarterly Consultation No.14 (September 2016).

58 Handbook Notice No.39 (December 2016).

59 GC16/7 Revised proposed guidance on guarantor loans (October 2016).

60 GC16/2 Proposal to issue guidance on the FCA's view of enforcing security under the Consumer Credit Act 1974: Guarantor loans – default notices (February 2016).

61 FG17/1 Guarantor loans: default notices (January 2017) – <https://www.fca.org.uk/publications/finalised-guidance/guarantor-loans>

62 CP17/6 Quarterly Consultation No.16 (March 2017), Chapter 8.

63 Handbook Notice No.45 (June 2017) – <https://www.fca.org.uk/publication/handbook/handbook-notice-45.pdf>

64 Call for Input: Review of retained provisions of the Consumer Credit Act (February 2016) – <https://www.fca.org.uk/news/news-stories/call-input-review-retained-provisions-consumer-credit-act>

in February 2016, inviting initial views on planning the review, and intend to publish a feedback statement shortly.

Credit Card Market Study

6.8 In July 2016 we published a report on the final findings of our Credit Card Market Study.⁶⁵ This gave further details of our proposed package of remedies, including some voluntary measures agreed with the industry such as alerting customers when they are nearing their credit limit.

6.9 On 3 April 2017 we published a consultation paper (CP) on some rule-based remedies in relation to persistent debt and earlier intervention.⁶⁶ The deadline for responses was 3 July, and we intend to publish our rules in a policy statement once we have completed our assessment of the responses.

6.10 Alongside this we are testing possible measures to address under-repayment, such as presenting repayment options differently, and may consider consulting on remedies next year. We will also be monitoring how effective the voluntary industry standards are.

High-cost credit

6.11 We introduced a price cap on HCSTC in January 2015 and committed to review this in the first half of 2017.⁶⁷

6.12 To support this review, we published a Call for Input in November 2016 seeking views from stakeholders on how the cap has worked since it came into effect.⁶⁸

6.13 The Call for Input also sought views and evidence on issues and concerns with high-cost credit products more generally, including arranged and unarranged overdrafts. The views and evidence we have gathered are helping us develop our future work in this area.

6.14 We have now published the outcome of our review of the price cap and next steps on high-cost credit generally.⁶⁹

Incentives and remuneration

6.15 On 4 July 2017 we published a CP on staff incentives, remuneration and performance management in consumer credit.⁷⁰ This outlines our thematic review findings on firms' policies, procedures and practices in these areas, and proposes a new rule and guidance to ensure firms effectively identify and manage risks to customers.

6.16 We are also proposing non-Handbook guidance to help firms better understand our expectations in this area. This includes detailed examples of potential risks and how these might be managed, and examples of good and poor practice we found during our thematic review. The deadline for responses to the CP is 4 October 2017.

65 MS14/6.3 Credit card market study: final findings report (July 2016).

66 CP17/10 Credit card market study: consultation on persistent debt and earlier intervention remedies (April 2017) – www.fca.org.uk/media/cp17-10-proposed-package-remedies

67 PS14/16 Detailed rules for the price cap on high-cost short-term credit (November 2014).

68 Call for Input: High-cost credit including review of the high-cost short-term credit price cap (November 2016).

69 FS17/2 High-cost credit including review of the high-cost short-term credit price cap (July 2017) – www.fca.org.uk/publications/feedback-statements/fs17-2-high-cost-short-term-credit

70 CP17/20 Staff incentives, remuneration and performance management in consumer credit – www.fca.org.uk/publication/consultation/cp17-20.pdf



Motor finance

- 6.17** Consumers' use of motor finance has grown rapidly in recent years, with many credit products now available. Some of these products may look similar to consumers, but they can operate very differently in practice. As we set out in our Business Plan 2017/18, we are looking at this market to develop our understanding of these products and how they are sold, and to assess whether the products cause harm to consumers.
- 6.18** We are taking forward a range of work to help us answer these questions, and to decide what further interventions may be necessary. This includes supervisory work with FCA-authorized lenders, detailed analysis of millions of anonymised CRA records, and careful scrutiny of firms' sales practices and processes. We are also working closely with the Bank and PRA, who are considering the risks raised by the expansion of motor finance that fall within their regulatory remit.
- 6.19** We will publish an update on this work in Q1 2018.

Prudential work

- 6.20** We intend to explore the possible impact on the more significant FCA-only regulated consumer credit firms of the findings set out in the recent PRA Statement⁷¹ on consumer credit, and will continue to engage with the PRA and Bank on the wider issues.

Senior Managers and Certification Regime

- 6.21** The Bank of England and Financial Services Act 2016 includes the extension of the Senior Managers and Certification Regime (SM&CR) to all FSMA-authorized firms. This will affect firms who offer financial services and are regulated by us, including firms that undertake consumer credit activities.
- 6.22** We published a CP on 26 July 2017, inviting responses by 3 November.⁷² The Treasury has stated its intention that the regime should start from 2018.

Cold calling

- 6.23** In February 2015 we announced that we intended to review how our rules apply to cold calling and other unsolicited marketing of credit products and services, in particular HCSTC and debt management services.⁷³
- 6.24** We have looked at evidence of compliance with the current rules and considered complaints data and other relevant developments. We have also considered the extent to which our existing rules, and legislative requirements, address the problem of nuisance calls and texts and the potential for consumers to take out an inappropriate product or service as a result. This has prompted us to consider whether to do some future work on more general issues relating to cold calling and unsolicited marketing across all regulated financial services.
- 6.25** For the present, we remind consumer credit firms that they must comply with existing legislation and rules. In particular:

- The Privacy and Electronic Communications (EC Directive) Regulations 2003 apply to unsolicited telephone calls, fax messages and electronic mail messages. The

⁷¹ <http://www.bankofengland.co.uk/prs/Documents/publications/reports/prstatement0717.pdf>

⁷² CP17/25 Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms – www.fca.org.uk/firms/senior-managers-certification-regime

⁷³ CP15/6 Consumer credit – proposed changes to our rules and guidance (February 2015).

Information Commissioner's Office has published a guide which sets out what counts as 'consent' for these purposes.⁷⁴ The Data Protection Act 1998 is also relevant.

- We have relevant rules in CONC 2.5 (credit broking), CONC 3.10 (financial promotions not in writing) and CONC 8.9 (lead generators for debt services).



Annex 1

Questions in this paper

- Q1:** Do you agree with our proposed changes to the scope of the creditworthiness rules and proposed transitional arrangements?
- Q2:** Do you agree with our approach to the meaning of affordability and the factors that should be taken into account by firms?
- Q3:** Do you agree with our proposals on the use of income and expenditure information?
- Q4:** Do you agree with the factors which we propose that firms should have regard to when considering proportionality of processes for assessing creditworthiness including affordability?
- Q5:** Do you agree with our proposals for open-end and running-account credit, guarantor loans and peer-to-peer loans?
- Q6:** Do you have any views on our proposals in relation to firms' policies and procedures for creditworthiness assessment?
- Q7:** Do you have any views on the use of CRA data and products, or other data sources, as part of an assessment?
- Q8:** Do you have any other comments on our proposed changes to CONC in relation to creditworthiness including affordability?
- Q9:** Do you agree with our assessment of the costs and benefits of the proposed changes?
- Q10:** Do you have any comments on the equality and diversity implications or other aspects of our proposals?

Annex 2

Cost benefit analysis

Introduction

1. Section 138I of the Financial Services and Markets Act 2000 (FSMA) requires the FCA to publish a cost benefit analysis (CBA) unless, in accordance with section 138L, we believe there will be no increase in costs or the increase will be of minimal significance. Section 138I also requires us to publish, as part of the CBA, an estimate of costs and benefits unless, in our opinion, we cannot reasonably estimate them or it is not reasonably practicable to produce an estimate.
2. We do not consider that the proposed changes will give rise to costs of more than minimal significance where firms are complying with our existing rules and principles. As such, we are not required to publish a CBA, given the exemption in section 138L. However, we use this Annex to set out our reasons for this.

Creditworthiness and affordability

3. The main purpose of the changes is to restructure and clarify the creditworthiness requirements. This is in light of both our research findings and feedback from firms and trade bodies. These suggest that some firms are unsure what is required under CONC and want greater clarity on our expectations. As a result, some firms may not be doing enough, and may be unintentionally under-complying, while others may be doing more than is necessary and proportionate in the circumstances.
4. The main benefits of the proposals are in enhancing regulatory certainty and so improving compliance by firms, while at the same time minimising the risk of 'over-compliance' which could add unnecessary costs or restrict availability unnecessarily. Firms will benefit from having a clearer understanding of our regulatory expectations which should reduce compliance costs and promote level playing fields. Consumers will benefit from creditworthiness assessments which consider affordability appropriately and so minimise the risk of predictable financial distress, without over-complicating the application process or leading to other unintended negative effects.
5. We do not consider that the proposals will result in an increase in costs of more than minimal significance. In particular:
 - We propose a single creditworthiness assessment requirement, in place of the obligation to assess potential adverse impacts. This will affect certain agreements secured on land⁷⁵ and pawnbroking agreements. In practice, there is currently very

⁷⁵ Most credit agreements secured on land are now subject instead to our Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).



little difference between the two obligations, and very few agreements that will be affected, and we expect the change to have little or no impact.

- We propose to exempt those pawnbroking agreements in relation to which firms are currently entitled to base assessments wholly or mainly on the value of the security. Again, this is unlikely to have a material impact.
- We propose to apply the creditworthiness requirements without limitation to agreements to finance payments arising on, or connected with, a person's death.⁷⁶ This restores the position to what it was before the transfer of regulation. We expect that firms will have continued to operate such agreements after 1 April 2014 in the same way as before that date, and will not have introduced different processes for what is likely to be a very small number of agreements. We are also ensuring that all prospective agreements of this type are subject to our requirements on pre-contractual adequate explanations. For the reasons stated earlier, we do not consider that these proposals will have any material impact on firms' practices.
- We propose to clarify the meaning of affordability. This makes explicit what is already implicit in CONC, bringing together existing elements into one place and clarifying that income must be the customer's own.
- We propose to clarify the role of income and expenditure information in the assessment. In particular, it may not always be necessary to establish the customer's income, as it may be self-evident that the credit is affordable without this, and an estimate may be sufficient. Having established income, it may not always be necessary to establish non-discretionary expenditure, and again an estimate may be sufficient, for example, based on ONS or other statistical data. Firms should decide what is reasonable and proportionate in the circumstances.
- Where income and expenditure are taken into account, the firm will be required to take account of reasonably foreseeable material changes over the period of the credit. This would include likely increases in mortgage repayments, for example, due to an interest rate rise. This is in line with existing CONC standards.
- We propose to clarify what we mean by proportionality and how we expect firms to take it into account in an assessment. The list of factors we expect firms to take into account is broadly similar to the current CONC provisions, but reflects affordability more closely as it focuses on the cost, amount and other features of the credit. We are not prescribing how these factors should be taken into account, or what information firms should use or verify.
- In some cases, existing CONC guidance will become rules. However, we think this will improve regulatory certainty without fundamentally altering firms' obligations under the regulatory regime. We are not prescribing how firms should comply, and the emphasis will continue to be on proportionality.
- For example, we are proposing that guidance on open-end agreements and running-account credit, such as credit cards, should become rules, but we are not prescribing the assumptions firms should use. We do not think the changes will make a material difference to firms' practices.

⁷⁶ See paragraph 5.9 above.

6. The rest of this Annex focuses on our proposals in relation to peer-to-peer lending and firms' policies and procedures for creditworthiness assessments.

Peer-to-peer lending

7. The proposed changes for P2P platforms largely mirror those for lenders. In addition, we propose to extend the obligation to assess creditworthiness to include a significant post-contractual increase in the amount of credit or the credit limit.
8. Based on our understanding of available products and market practices, we consider that any increase in costs will be no more than minimal.
9. We are not aware of any current P2P lending to consumers which is running-account credit (and involves a credit limit) or, if fixed-sum, could involve an increase in the amount of credit advanced under the agreement.
10. While some loans to businesses may be structured in tranches, or permit the credit to be drawn down in stages, we understand that this typically involves a set amount of credit which does not increase subsequently. If further credit is needed, this will typically involve a fresh agreement with a fresh creditworthiness assessment. There is more variety in relation to loans to limited companies but these are not P2P agreements for the purposes of the CONC rules.
11. As such, we think our proposal to extend the obligation to post-contractual increases will have no, or minimal, impact on current regulated P2P lending.
12. The P2P lending market continues to develop and innovate, and different products may emerge in the future. However, we are not presently aware of any developments that suggest that firms intend to provide loans to individuals via P2P platforms where the amount of credit or the credit limit might be increased subsequently.
13. In any case, we consider that any increase in costs would be no more than of minimal significance. Insofar as regulated P2P agreements in the future could involve a significant increase in the amount of credit or the credit limit, it is likely that the platform would undertake an assessment. This is because of the importance of creditworthiness assessments for investment decisions and the platform's liquidity. In doing so, they would be likely to repeat the initial, obligatory assessment, which in most cases is largely automated and so involves minimal incremental costs. However, we recognise that – even if platforms have strong commercial incentives to undertake a further assessment – there needs to be a rule requiring this, to ensure that borrowers receive consistent levels of protection irrespective of whether the lending is by way of business and whether therefore the P2P investor is subject to CONC.

Policies and procedures

14. The current CONC provisions require firms to establish and implement clear and effective policies and procedures to make a reasonable creditworthiness assessment. This supports Principle 3 in our high-level Principles for Businesses (PRIN) which



requires firms to take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems.

15. Consumer credit firms must also comply with existing SYSC requirements.
16. We propose to give more detail to the current requirements, by requiring firms to:
 - a. Establish, implement and maintain clear and effective policies and procedures to enable the firm to carry out reasonable creditworthiness assessments. Firms must also set out the principal factors they will take into account, set out these policies and procedures in writing and – unless they are a sole trader – have them approved by the firm’s governing body or other senior personnel.
 - b. Assess and periodically review how effective these policies and procedures are and how well the firm is complying with them and with its obligations under CONC 5.2A (or CONC 5.5A in the case of P2P platforms). In light of their review, they must take appropriate measures to address any deficiencies.
 - c. Maintain a record of each relevant transaction, which is sufficiently detailed to demonstrate that a creditworthiness assessment was carried out where required and that it was reasonable and in accordance with CONC 5.2A (or 5.5A). This will enable us to monitor the firm’s compliance with its obligations.
 - d. Establish, implement and maintain robust governance arrangements and internal control mechanisms to ensure the firm’s compliance with the above requirements.
17. We consider that any increase in costs from these proposals will be of minimal significance for a firm already complying with CONC and SYSC.
18. On (a), CONC 5.3.2R already requires firms to establish and implement clear and effective policies and procedures to make a reasonable creditworthiness assessment. SYSC 6.1 also requires firms to establish, implement and maintain adequate policies and procedures sufficient to ensure that the firm complies with its obligations under the regulatory system. Accompanying guidance refers to firms having adequate policies and procedures to detect and minimise any risk of non-compliance and to enable the appropriate regulator to exercise its powers effectively.
19. A policy is unlikely to be clear and effective, or the firm is unlikely to be able to satisfy itself and us on this, if it is not in writing or does not set out, in sufficient detail, the basis on which the firm will make creditworthiness assessments. We are proposing only that the principal factors are set out, rather than every consideration that may influence an assessment. We are not prescribing what these factors should be or how they should be taken into account in the assessment.
20. On (b), it is similarly unlikely that a firm can satisfy itself and us that its policies and procedures are effective if it does not review this periodically. As above, SYSC 6.1 requires firms to maintain adequate policies and procedures. Accompanying guidance refers to firms monitoring and, on a regular basis, assessing the adequacy and effectiveness of measures and procedures put in place to ensure compliance and actions taken to address any deficiencies in the firm’s compliance with its obligations.
21. SYSC 4.3 requires firms to ensure that their senior personnel assess, and periodically review the effectiveness of, the policies, arrangements and procedures put in place to

comply with the firm's obligations under the regulatory system and take appropriate measures to address any deficiencies. Accompanying guidance refers to senior personnel receiving – on a frequent basis, and at least annually – written reports indicating whether appropriate remedial measures have been taken.

- 22.** We are not prescribing the form of such monitoring or compliance reviews, or their frequency, or how the results should be assessed.
- 23.** Given that senior personnel must review the effectiveness of a firm's policies and procedures under SYSC 4.3, we do not consider that it would add more than minimally significant costs to require them also to approve the policies and procedures or, alternatively, to have them approved by the firm's governing body.
- 24.** On (c), SYSC 9.1 requires firms to arrange for orderly records to be kept of their business and internal organisation, including all services and transactions undertaken. The records must be sufficient to enable us to monitor the firm's compliance with requirements under the regulatory system, and in particular to assess whether the firm has complied with all obligations to clients.
- 25.** We propose to clarify that this must include all cases where credit is granted or there is a significant increase in the amount of credit or the credit limit. The record must be sufficient to demonstrate that a creditworthiness assessment was carried out, where required, and was reasonable and in accordance with CONC.
- 26.** We are not prescribing the form of the record, or the degree of detail. The proposal would apply only where a firm grants credit – it would not need to keep a record in cases where it rejects an application.
- 27.** SYSC guidance makes clear that, as a general principle, records should be capable of being reproduced on paper and should be retained for as long as is relevant for the purposes for which they are made. For example, it may be necessary to reconstruct a lending decision to monitor compliance or if a complaint is made, in particular during the period of the credit agreement.
- 28.** On (d), this reinforces SYSC 4.1 which requires firms to have robust governance arrangements and effective processes to identify, manage, monitor and report risks. It also requires firms to establish, implement and maintain adequate internal control mechanisms to secure compliance with decisions and procedures at all levels of the firm. Accompanying guidance refers to such arrangements, processes and mechanisms being comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the firm's business model and activities.
- 29.** Given the central importance of creditworthiness assessments for lenders and P2P platforms, we consider this is a helpful elaboration of the SYSC requirements.
- 30.** More generally, by providing detail on the existing requirements, and fleshing out what they mean for firms undertaking creditworthiness assessments, we hope this will be helpful in explaining our regulatory expectations and facilitating compliance.
- 31.** Where a firm is not currently conducting adequate creditworthiness assessments, it may need to make changes which could affect customers. However, where these changes merely bring the firm into compliance with the current regulatory regime, we can disregard any associated costs for CBA purposes. Where a firm previously had



procedures that were unnecessary or disproportionate because they misunderstood our expectations, they may be able to implement changes that reduce some processes and benefit customers, provided that affordability checks are still adequate.

32. On balance, we consider that any increase in costs for firms will be those which are necessary to bring the firm into compliance with the current regulatory regime or of only minimal significance, but we would welcome views on this.

Q9: Do you agree with our assessment of the costs and benefits of the proposed changes?

Annex 3

Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of our reasons for concluding that the proposals are compatible with certain requirements under FSMA.
2. When consulting on new rules, we are required by section 138I(2)(d) FSMA to explain why we believe making the proposed rules is compatible with our general duty under section 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with our strategic objective and advances one or more of our operational objectives, and with our general duty under section 1B(5)(a) FSMA to have regard to the regulatory principles in section 3B FSMA.
3. This Annex also sets out our view of how the proposed rules are compatible with the duty on us to discharge our general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives. We are also required by section 138K(2) to state our opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
4. This Annex also includes our assessment of the equality and diversity implications of our proposals and invites comments.
5. In addition, this Annex explains how we have considered the recommendations made by the Treasury under section 1JA FSMA about aspects of the Government's economic policy to which we should have regard in connection with our general duties.
6. Under the Legislative and Regulatory Reform Act 2006 (LRRRA) we are required to have regard to a number of high-level Principles in the exercise of some of our regulatory functions and to have regard to a Regulators' Code when determining general policies and principles and giving general guidance (but not when exercising other legislative functions such as making rules). This Annex sets out how we have complied with requirements under the LRRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. The proposed rules set out in this consultation are primarily intended to advance our operational objective of securing an appropriate degree of protection for consumers.



8. The proposals also promote effective competition in the interests of consumers, by seeking to ensure that all relevant firms understand our regulatory requirements and expectations and offer credit fairly and responsibly. In addition, they promote market integrity as credit risk assessments can have prudential implications, and may impact on financial stability, and irresponsible lending by firms can negatively impact their reputation and consumer confidence in the market.

9. We consider these proposals are compatible with our strategic objective of ensuring that relevant markets⁷⁷ function well. They apply to all regulated lending (with some minor exceptions which also applied under the previous CCA regime) and aim to promote responsible lending and the provision of affordable credit.

10. In preparing the proposals set out in this consultation we have had regard to the regulatory principles in section 3B FSMA, as set out below.

The need to use our resources in the most efficient and economic way

11. We do not believe that our proposals will have a significant impact on our resources or the way in which we use them. They should improve our ability to supervise firms effectively and to enforce compliance with our rules. They will also allow us to target our resources on the areas of greatest potential harm to consumers and the market.

The principle that a burden or restriction should be proportionate to the benefits

12. We have concluded that our proposals will not impose costs of more than minimal significance. More generally, we are satisfied that any burdens imposed on firms by the proposed rules and guidance are proportionate to the expected benefits.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

13. We do not believe our proposals undermine this principle. Affordable credit can drive economic growth, but unsustainable credit can lead to over-indebtedness and other debt-related problems, and can have wider economic and social impacts. Our proposals should promote compliance, whilst minimising risk of 'over-compliance'.

The general principle that consumers should take responsibility for their decisions

14. Our proposals support this general principle. We recognise the importance of responsible borrowing, but this is helped where lenders act responsibly and with adequate regard to the ability of their customers to repay.

The responsibilities of senior management

15. Our proposals support this general principle. We are proposing that a firm's policies and procedures should be approved by its governing body or senior personnel, and that firms should have robust governance arrangements designed to ensure the firm's compliance with its regulatory obligations.

The desirability of recognising differences in the nature and objectives of businesses carried on by different persons

16. The emphasis on proportionality recognises that firms may have different products and processes, with differing levels of risk to consumers, and that they should decide what is appropriate in the particular circumstances. We want to avoid over-prescription.

77 'Relevant markets' are defined in section 1F FSMA.

The desirability of publishing information relating to persons subject to requirements under FSMA, or requiring them to publish information

17. We have had regard to this principle and do not believe our proposals undermine it. We may consider publishing additional information or guidance in due course if it appears necessary or appropriate to further clarify our regulatory expectations.

The principle that we should exercise our functions as transparently as possible

18. We are an open and transparent regulator. While developing these proposals we met stakeholders and invited views via roadshows and other events. We are publishing our proposals and inviting comments, and will take responses into account.
19. In formulating these proposals we have had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on by an authorised person, or in contravention of the general prohibition, to be used for a purpose connected with financial crime, as required by section 1B(5)(b) FSMA. If firms make rigorous credit risk assessments, this should minimise the risk of financial crime.

Expected effect on mutual societies

20. We do not expect the proposals in this consultation paper to have a significantly different impact on mutual societies.
21. Our proposals will apply where such persons are lending under regulated credit agreements (unless a specific exemption applies), but will not apply differently to other firms and will be subject to proportionality. Where the costs and risks of borrowing are low, a firm may be able to reasonably satisfy itself on affordability without having to undertake rigorous or costly checks.

The consumer protection objective

22. We have considered what is the appropriate degree of protection for consumers in light of the matters set out in section 1C FSMA.

Differing degrees of risk involved in different kinds of investment or other transaction

23. Our proposals are rooted in the principle that the extent and scope of an assessment of creditworthiness, including affordability, should be proportionate when considered against the costs and risks to the individual borrower. In general, where the actual and potential risks are greater, the assessment should be more rigorous and have greater supporting information. On the other hand, where the costs and risks are low the firm may be able to satisfy itself on affordability without undertaking detailed checks or may be able to rely on proxy information, for example, from a CRA.

Differing degrees of experience and expertise that different consumers may have

24. Promotion of responsible lending should particularly enhance protection of non-prime and vulnerable consumers. The proposals should also encourage and facilitate responsible borrowing, given that some consumers may suffer from behavioural biases (such as 'present bias' or over-confidence) or may lack financial sophistication and so might make borrowing decisions which are not in their best interests.



The needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose

25. Lenders are not expected to advise customers on their borrowing decisions, but our proposals may facilitate appropriate advice by credit brokers and other persons. They may also make it easier for lenders to explain why a credit application was rejected.

The general principle that consumers should take responsibility for their decisions

26. Our proposals aim to promote responsible lending and reduce the risk of credit being unaffordable, but responsible borrowing is also important. Consumers should act with prudence and assess whether they can afford a particular credit commitment, including if their circumstances change, and provide accurate information to lenders.

The general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question

27. Our proposals require an adequate assessment of an individual customer's ability to repay which takes into account any potential negative impact on their financial situation. Firms should decide what is reasonable and appropriate in the particular circumstances, having regard to the costs and risks to the borrower.

The differing expectations that consumers may have in relation to different kinds of investment or other transaction

28. Proportionality is likely to be in line with consumer expectations. A consumer may anticipate a more rigorous assessment of creditworthiness where they are applying for a large amount of credit or where the costs of the credit are high. They may expect a less rigorous assessment for smaller or lower-cost loans or where the credit is self-evidently affordable based on, for example, their employment or income.

The duty to promote effective competition in the interests of consumers

29. In preparing the proposals set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.
30. Competition is enhanced if firms operate on the basis of level playing fields and with a common understanding of the regulatory regime and regulatory expectations. Otherwise some firms may gain an advantage by undertaking less rigorous checks on affordability, while still satisfying themselves on credit risk, while others may do more than is required or necessary in the circumstances. In doing so, they may incur additional costs that could have a negative impact on their lending and profitability.
31. The emphasis on proportionality allows firms to tailor their approach according to the nature of the credit and the costs and risks to the individual borrower. In contrast, a more prescriptive approach could lead some firms to scale down their lending or exit the market. It could increase costs to firms, and barriers to entry and expansion.
32. In addition, over-prescription could have the effect of limiting or preventing desirable innovation to the benefit of firms and consumers. For example, it may not allow for new and innovative approaches to assessing affordability.

Equality and diversity

- 33.** We are required under the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions.
- 34.** As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered. The outcome of our initial assessment is set out in Chapter 2.

Legislative and Regulatory Reform Act 2006 (LRR)

- 35.** We have had regard to the principles in the LRR and the Regulators' Code for the parts of our proposals that consist of general policies, principles or guidance. We consider that they are proportionate and result in an appropriate level of consumer protection, without creating undue burdens on firms or an adverse impact on competition.

Treasury recommendations about economic policy

- 36.** We have had regard to the Treasury's recommendations under section 1JA FSMA. In particular, we have had regard to the importance of competition, growth and innovation and securing better outcomes for consumers.

Q10: Do you have any comments on the equality and diversity implications or other aspects of our proposals?



Annex 4

Abbreviations in this document

APR	Annual percentage rate of charge
Bank	Bank of England
CBA	Cost benefit analysis
CCA	Consumer Credit Act 1974
CCD	Consumer Credit Directive (2008/48/EC)
CONC	Consumer Credit sourcebook
CP	Consultation paper
CRA	Credit reference agency
DTI	Debt-to-income ratio
EU	European Union
FCA	Financial Conduct Authority
FPC	Financial Policy Committee
FSMA	Financial Services and Markets Act 2000
HCSTC	High-cost short-term credit
LRRA	Legislative and Regulatory Reform Act 2006
MCOB	Mortgages and Home Finance: Conduct of Business sourcebook
OFT	Office of Fair Trading
ONS	Office for National Statistics
OP	Occasional Paper
P2P	Peer-to-peer
PRA	Prudential Regulation Authority
PS	Policy statement

SYSC	Senior Management Arrangements, Systems and Controls sourcebook
UK	United Kingdom
WAS	Wealth & Assets Survey

We have developed the policy in this consultation paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this consultation paper from our website: www.fca.org.uk.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 9644 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.



Appendix 1

Draft Handbook text

CONSUMER CREDIT (CREDITWORTHINESS) INSTRUMENT 2017

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*date*] 2018.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Consumer Credit sourcebook (CONC) is amended in accordance with Annex B to this instrument.

Notes

- F. In Annex B to this instrument, the notes (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- G. This instrument may be cited as the Consumer Credit (Creditworthiness) Instrument 2017.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary

In this Annex, underlining indicates new text and striking through indicates deleted text.

<i>credit-worthiness assessment</i>	the assessment, including as to the affordability of credit by the customer, required by CONC 5.2.1R <u>5.2A.4R</u> or <u>CONC 5.5A.5R</u> .
...	
<i>priority debt</i>	(in <i>BCOBS</i> , <u>CONC 5.2A</u> and <u>CONC 5.5A</u>) an obligation on the part of a <i>consumer</i> to make a payment:
	(a) ...
...	
<i>sustainable</i>	(in <i>CONC</i>) has the meaning given in CONC 5.3.1G <u>the ability of the customer to make repayments under a credit agreement in accordance with CONC 5.2A.10R.</u>
<i>unsustainable</i>	(in <i>CONC</i>) has the meaning given in CONC 5.3.1G <u>the inability of the customer to make repayments under a credit agreement in accordance with CONC 5.2A.10R (or, in the case of a borrower under a P2P agreement, in accordance with CONC 5.5A.11R).</u>

Annex B

Amendments to the Consumer Credit sourcebook (CONC)

In this Annex underlining indicates new text and striking through indicates deleted text, unless indicated otherwise.

2 Conduct of business standards: general

...

2.10 Mental capacity guidance

...

2.10.18 G Where a *firm* understands, or reasonably suspects, a *customer* has or may have a mental capacity limitation it should apply a high level of scrutiny to the *customer's* application for *credit*, in order to mitigate the risk of the *customer* entering into *unsustainable* borrowing (~~see CONC 5.2 and CONC 5.3~~).

...

2.10.19 G (2) Where a *firm* understands or reasonably suspects a *customer* has or may have a mental capacity limitation, it should undertake an appropriate and effective *creditworthiness assessment* (see CONC 5.2A) ~~or assessment required by CONC 5.2.2R(1)~~ and it would be appropriate not to place over-reliance on information provided by the *customer* for the assessment.

...

3 Financial promotions and communications with customers

...

3.8 Financial promotions and communications: lenders

...

3.8.2 R A *firm* must not in a *financial promotion* or a communication with a *customer*:

(1) provide an application for *credit* with a pre-completed amount of credit which is not based on having carried out a *creditworthiness assessment* ~~or an assessment required by CONC 5.2.2R(1)~~; or

[**Note:** paragraph 5.3 of *ILG*]

...

4 Pre-contractual requirements

...

4.2 Pre-contract disclosure and adequate explanations

...

4.2.5 R ...

- (8) ~~Where this *rule* applies to a *borrower lender agreement* to finance the making of payments arising on or connected with the death of a person, the payments in question are set out in (9).~~

~~[Note: section 74(1F) of CCA] [deleted]~~

- (9) ~~The payments referred to in (8) are:~~

~~(a) inheritance tax chargeable in the *UK* on the death of any person;~~

~~(b) fees payable to a court:~~

~~(i) in England, Wales or Northern Ireland on an application for a grant of probate or of letters of administration;~~

~~(ii) in Scotland, in connection with a grant of confirmation; and~~

~~(iii) in the *UK*, on an application for resealing of a Commonwealth or colonial grant of probate or of letters of administration; and~~

~~(e) payments in England, Wales or Northern Ireland to a surety in connection with a guarantee required as a condition of a grant of letters of administration or payments in Scotland to a cautioner in connection with a bond of caution required as a condition of issuing a grant of confirmation.~~

~~[Note: regulation 2 of SI 1983/1554] [deleted]~~

~~[Note: article 5(6) of the Consumer Credit Directive]~~

...

4.8 Pre-contract: unfair business practices: consumer credit lending

...

4.8.5 G Merely offering a *customer* more *credit* than the *customer* requested would not amount to the behaviour in *CONC* 4.8.4R where:

- (1) ~~the offer of the higher amount was based on a proper *creditworthiness assessment* or assessment required by *CONC* 5.2.2R(1); or~~
- (2) ~~the *firm* offers more advantageous terms, conditions or prices to *customers* for larger loans, provided that such offers are sufficiently transparent and a proper *creditworthiness assessment* or assessment~~

~~required by CONC 5.2.2R (1)~~ has been carried out;

and the *customer* was not pressurised or unfairly coerced into accepting the higher amount of *credit*.

...

CONC 5.1 (Application), 5.2 (Creditworthiness assessment: before agreement) and 5.3 (Conduct of business in relation to creditworthiness and affordability) are deleted in their entirety. The deleted text is not shown.

5.1 **Application** [deleted]

5.2 **Creditworthiness assessment: before agreement** [deleted]

5.3 **Conduct of business in relation to creditworthiness and affordability** [deleted]

After the deleted CONC 5.2 (Creditworthiness assessment: before agreement) insert the following new text. It is not shown underlined.

5.2A **Creditworthiness assessment**

Application

5.2A.1 R Subject to CONC 5.2A.2R, this section applies to a *firm* with respect to *consumer credit lending*.

5.2A.2 R This section does not apply to:

- (1) an agreement under which a *firm* takes an article or articles in *pawn* and under the terms of the agreement:
 - (a) the *customer's* total financial liability (including in respect of capital, interest and all other charges including any expenses of sale) is not capable of exceeding the true market value of the article or articles *pawned* by the *customer*; and
 - (b) the effect of the passing of property in the *pawned* article or articles to the *firm* under section 120 of the *CCA*, or of a sale of the article or articles under section 121 of the *CCA*, would, therefore, be (at the very least) to discharge the debt secured by the *pawn* and any other obligation to pay a sum of money under the agreement including any expenses of sale;

- (2) a current account agreement where:
 - (a) there is a possibility that the account-holder may be allowed to overdraw on the current account without a pre-arranged overdraft or to exceed a pre-arranged overdraft limit; and
 - (b) if the account-holder did so, this would be a *regulated credit agreement* (overrunning);
- (3) a *non-commercial agreement*; or
- (4) a *small borrower-lender-supplier agreement* which is a *restricted-use credit agreement*.

Interpretation

- 5.2A.3 R In this section, references to repayment refer to repayment of capital or payment of interest or other charges (excluding any charge for non-compliance with a *regulated credit agreement*).

Creditworthiness assessment

- 5.2A.4 R A *firm* must undertake a reasonable assessment of the creditworthiness of a *customer* before:
- (1) entering into a *regulated credit agreement*; or
 - (2) significantly increasing the amount of *credit* provided under a *regulated credit agreement*; or
 - (3) significantly increasing a *credit limit* for *running-account credit* under a *regulated credit agreement*.
- 5.2A.5 G If an increase in the amount of *credit* or in the *credit limit* is not itself significant but would result in there having been, since the last *creditworthiness assessment*, a cumulative increase that is significant, then a further *creditworthiness assessment* is required. This may be the case, for example, where a number of consecutive increases have been made over a period, none of which is significant when considered in isolation but the aggregate sum of which is significant.
- 5.2A.6 R A *firm* must base its *creditworthiness assessment* on sufficient information:
- (1) of which it is aware at the time the *creditworthiness assessment* is carried out;
 - (2) obtained, where appropriate, from the *customer*, and where necessary from a *credit reference agency*, and
- the information must enable the *firm* to carry out a reasonable *creditworthiness assessment*.

5.2A.7 G *CONC 5.2A.19R to CONC 5.2A.23G contain rules and guidance in relation to the factors that should be taken into account in an individual case when deciding how much information is sufficient for the purposes of the creditworthiness assessment, what information it is appropriate and proportionate to obtain and assess, and whether and how the accuracy of the information should be verified.*

5.2A.8 R *Rules and guidance in this section apply in relation to carrying out a creditworthiness assessment.*

The subject matter of the creditworthiness assessment

5.2A.9 R The *firm* must consider:

- (1) the risk that the *customer* will not make one or more repayments under the agreement by the due date; and
- (2) the risk to the *customer* of not being able to make repayments under the agreement in accordance with *CONC 5.2A.10R* (referred to as ‘affordability risk’ in this section).

5.2A.10 R The *firm* must consider the *customer’s* ability to make repayments under the agreement:

- (1) as they fall due over the life of the agreement and, where the agreement is an *open-end agreement*, within a reasonable period;
- (2) wholly out of the *customer’s* income, except to the extent that the *customer* has indicated clearly an intention to repay (wholly or partly) using savings or other assets;
- (3) without the *customer* having to borrow to meet the repayments;
- (4) without failing to make any other payment the *customer* has a contractual or statutory obligation to make; and
- (5) without the repayments having a significant adverse impact on the *customer’s* financial situation.

5.2A.11 R If the *customer* intends to make repayments (wholly or partly) using savings or other assets, the *firm* must take into account:

- (1) the purpose for which the savings or assets are or will be held;
- (2) the likelihood of the savings or assets being available to make repayments under the agreement; and
- (3) any significant adverse impact on the *customer’s* financial situation of using those savings or assets.

5.2A.12 R When considering affordability risk, the *firm* must not take into account the existence of (or the intention to provide or request the provision of) any

guarantee or indemnity or other form of *security*.

The customer's income and expenditure

- 5.2A.13 R (1) This *rule* applies unless:
- (a) the *firm* can demonstrate that it is obvious in the circumstances of the particular case that the *customer* is able to make repayments in accordance with *CONC 5.2A.10R*, so as to make the actions described in (2) to (4) disproportionate; or
 - (b) the *customer* has indicated clearly an intention to repay wholly using savings or other assets (see *CONC 5.2A.11R*).
- (2) The *firm* must take reasonable steps to determine the amount, or make a reasonable estimate, of the *customer's* current income.
- (3) Where it is reasonably foreseeable that there is likely to be a reduction in the *customer's* income:
- (a) during the term of the agreement; or
 - (b) in the case of an *open-end agreement*, during the likely duration of the *credit* (see *CONC 5.2A.24R*),
- which could have a material impact on affordability risk, the *firm* must take reasonable steps to estimate the amount of that reduction.
- (4) The *firm* must take account of the *customer's* income it has determined or estimated in accordance with (2) and (3).
- (5) The *firm* may only take into account an expected future increase in the *customer's* income where the *firm* reasonably believes on the basis of appropriate evidence that the increase is likely to happen during the term of the agreement or, in the case of an *open-end agreement*, during the likely duration of the *credit*.
- 5.2A.14 R (1) Except as set out in (2), the *firm* must not have regard, in considering affordability risk, to the income of any *person* other than the *customer* (or *customers* in the case of joint *borrowers* who are or will be parties to the agreement). Where there is or may be a guarantee or indemnity in relation to the agreement, the *firm* must comply with *CONC 5.2A.31R*.
- (2) The *firm* may have regard to income from jointly-held savings or assets in so far as it is reasonable to expect such income to be available to the *customer* to make repayments under the agreement.
- 5.2A.15 G (1) A *firm* that proposes to rely on the exception in *CONC 5.2A.13R(1)(a)* should keep in mind that the burden would be on the *firm* to demonstrate, if challenged, that the absence of a material affordability risk was obvious such as to make the process of determination or

estimation of the *customer's* income disproportionate.

- (2) An estimate of the *customer's* income may include a minimum amount or a range, provided that any assumptions on which the estimate is based are reasonable in the circumstances.
- (3) For the purpose of considering the *customer's* income under *CONC* 5.2A.13R, it is not generally sufficient to rely solely on a statement of income made by the *customer* without independent evidence (for example, in the form of information supplied by a *credit reference agency* or documentation of a third party supplied by the third party or by the *customer*).
- (4) An example of where it may be reasonable to take into account an expected future increase in income would be a loan to fund the provision of further or higher education, provided that an appropriate assessment required by this section is carried out. If, in such a case, the *customer's* income does not increase in line with expectations, the *firm* should consider deferring or limiting the obligation to repay until the *customer's* income has reached an appropriate level.

5.2A.16 R (1) This *rule*:

- (a) applies only where *CONC* 5.2A.13R also applies; and
 - (b) does not apply where the *firm* can demonstrate that it is obvious in the circumstances of the particular case that the *customer's* non-discretionary expenditure is unlikely to have a material impact on affordability risk, so as to make the actions described in (2) to (4) disproportionate.
- (2) The *firm* must take reasonable steps to determine the amount, or make a reasonable estimate, of the *customer's* current non-discretionary expenditure.
 - (3) Where it is reasonably foreseeable that there is likely to be an increase in the *customer's* non-discretionary expenditure:
 - (a) during the term of the agreement; or
 - (b) in the case of an *open-end agreement*, during the likely duration of the *credit* (see *CONC* 5.2A.24R),

which could have a material impact on affordability risk, the *firm* must take reasonable steps to estimate the amount of that increase.

- (4) The *firm* must take account of the *customer's* non-discretionary expenditure it has determined or estimated in accordance with (2) and (3).
- (5) The *firm* may only take into account an expected future decrease in non-discretionary expenditure where the *firm* reasonably believes on

the basis of appropriate evidence that the decrease is likely to happen during the term of the agreement or, in the case of an *open-end agreement*, during the likely duration of the *credit*.

- 5.2A.17 G (1) Non-discretionary expenditure referred to in *CONC 5.2A.16R* includes payments needed to meet *priority debts* and other essential living expenses and other expenditure which it is hard to reduce to give a basic quality of life. It also includes payments the *customer* has a contractual or statutory obligation to make, such as payment obligations arising under a *credit agreement* or a mortgage contract.
- (2) An analysis of the size of the *customer's* debts compared to the *customer's* income may therefore form part of the *creditworthiness assessment* where detailed analysis of this kind is proportionate to the individual circumstances of the case, having regard to the factors listed in *CONC 5.2A.19R*.
- (3) Non-discretionary expenditure includes expenditure for other *persons* whose financial obligations the *customer* meets wholly or in part.
- (4) An estimate of non-discretionary expenditure may include a maximum amount or a range, provided that any assumptions on which the estimate is based are reasonable in the circumstances.
- (5) Where the *firm* can demonstrate that it is obvious that there is no material affordability risk and the exception from the requirement to determine or estimate the *customer's* income therefore applies, the *firm* is similarly not required to determine or estimate the *customer's* non-discretionary expenditure.
- 5.2A.18 G (1) For the purpose of considering the *customer's* non-discretionary expenditure under *CONC 5.2A.16R*, the *firm* may take into account statistical data unless it knows or has reasonable cause to suspect that the *customer's* non-discretionary expenditure is significantly higher than that described in the data or that the data are unlikely to be reasonably representative of the *customer's* situation.
- (2) It is unlikely to be appropriate to place reliance on statistical data, for example, where the *firm* is aware, or ought reasonably to be aware from information in its possession, that the composition of the *customer's* household, or the number of dependants that the *customer* has, or the level of the *customer's* existing indebtedness, differs significantly from that of the sample of persons on which the statistical data were based.

Scope, extent and proportionality of assessment

- 5.2A.19 R (1) The extent and scope of the *creditworthiness assessment*, and the steps that must be taken to satisfy the requirement that the assessment is a reasonable one, are dependent upon, and proportionate to, the individual circumstances of each case.

- (2) The *firm* must consider:
- (a) the types of information to use in the *creditworthiness assessment*;
 - (b) the content and level of detail of the information to use;
 - (c) whether the information in the *firm's* possession is sufficient;
 - (d) whether and to what extent it is appropriate to obtain additional information from the *customer*;
 - (e) whether and to what extent it is necessary to obtain information from a *credit reference agency*;
 - (f) any other sources of information to use;
 - (g) whether and to what extent to verify the accuracy of the information that is used;
 - (h) the degree of evaluation and analysis of the information that is used; and
 - (i) the steps to take to determine or estimate the *customer's* income or non-discretionary expenditure (where such a determination or estimate is required),

having regard to the factors listed in (3) where applicable to the agreement.

- (3) The factors to which the *firm* must have regard when complying with (2) and deciding what steps are needed to make the *creditworthiness assessment* a reasonable one include each of the following where applicable to the agreement:
- (a) the type of *credit*;
 - (b) the amount of the *credit* or, where applicable, the *credit limit*;
 - (c) the duration (or likely duration) of the *credit*;
 - (d) the frequency of the repayments;
 - (e) the amounts of the repayments;
 - (f) the *total amount payable*;
 - (g) the *total charge for credit*;
 - (h) the *annual percentage rate of charge*;

- (i) whether the rate of interest or any other charge (except any charge for non-compliance with the agreement) is fixed or variable;
 - (j) any other costs, including any charge for non-compliance with the agreement, which will or may be payable by or on behalf of the *customer* in connection with the agreement; and
 - (k) any other potential adverse consequences for the *customer* arising under the agreement from a failure to make a repayment by the due date.
- 5.2A.20 G (1) The *firm* should also have regard to information of which it is aware at the time the *creditworthiness assessment* is carried out that may indicate that:
- (a) the *customer* is in or has recently experienced financial difficulties (see *CONC* 1.3); or
 - (b) the *customer* is particularly vulnerable, for example because the *customer* has mental health difficulties or mental capacity limitations (see *CONC* 2.10 and *CONC* 7.2).
- 5.2A.21 G The *firm* may have regard, where appropriate, to information obtained in the course of previous dealings with the *customer* but should consider whether the passage of time could have affected the validity of the information and whether it is appropriate to update it.
- 5.2A.22 G (1) The volume and content of the information that must be taken into account, and the steps that must be taken (if any) to evaluate that information and confirm its validity, will depend on the level of affordability risk arising out of the agreement.
- (2) Key factors that will affect that level of risk include the actual or potential cost of the *credit* and the *total amount payable* in absolute terms and relative to the *customer's* financial circumstances, where known. So, if, for example, the amounts of the repayments and the *total charge for credit* are low and there are no or minimal charges payable in respect of non-compliance with the agreement, the amount of information that is sufficient to support a reasonable *creditworthiness assessment* may be less than would be required in the case of more expensive *credit* or *credit* that is higher in amount or where it is known that the *customer's* financial situation is such that the *credit* may be expected to have a more significant impact.
- 5.2A.23 G In relation to *CONC* 5.2A.22G(1), the level of affordability risk arising out of the agreement may be high where either:
- (1) the total value of the *customer's* outstanding debts relative to the *customer's* income is high; or

- (2) there is evidence reasonably to suggest that there is a high likelihood that the *customer* will not make one or more repayments under the agreement by the due date.

Types of credit

- 5.2A.24 R In relation to an *open-end agreement*, the *firm* must make a reasonable assumption about the likely duration of the *credit* which should take into account:
- (1) the terms and conditions of the agreement;
 - (2) any pre-contractual disclosure and explanation given to the *customer* under the *CCA* or *CONC*; and
 - (3) the *customer's* intentions, where known to the *firm*.
- 5.2A.25 R In relation to *running-account credit*, the *firm* must:
- (1) assume the *customer* draws down the entire *credit limit* (if any) at the earliest opportunity and repays by equal instalments over a reasonable period;
 - (2) make reasonable assumptions about likely further drawdowns and repayments over the duration or likely duration of the *credit* (including over the period referred to in (1));
 - (3) not use the assumption that the *customer* will only repay the amount necessary to meet the minimum repayment required each month or other payment period; and
 - (4) set the *credit limit* in the light of (1) to (3).
- 5.2A.26 G The effect of *CONC* 5.2A.25R(1) is that, where a *firm* proposes to significantly increase a *credit limit*, the *firm* should assume that the proposed higher *credit limit* is drawn down in its entirety at the earliest opportunity following the increase and repaid by equal instalments over a reasonable period that begins on the date of that drawdown.
- 5.2A.27 R If there is no *credit limit*, the *firm* must make a reasonable assumption about a maximum initial drawdown of *credit* for the purposes of *CONC* 5.2A.25R(1).
- 5.2A.28 G The *firm* should:
- (1) in considering the reasonable period in *CONC* 5.2A.25R(1), have regard to the typical time required for repayment that would apply to a fixed-sum unsecured personal loan for an amount equal to the *credit limit* (or, where there is no *credit limit*, the assumed initial drawdown), taking into account the terms and conditions of a loan likely to be available to that *customer* (whether from the *firm* or from

another *lender*) and any other factors that the *firm* reasonably considers to be relevant; and

- (2) in considering what are reasonable assumptions in *CONC* 5.2A.25R(2), have regard to typical drawdown and repayment patterns of its *customers* in relation to that product or type of product, or of *customers* of that type generally, but should also consider any factors particular to the individual *customer*, where known.

5.2A.29 G Where a *customer* is borrowing for business purposes it may be reasonable to take into account the *customer's* business plan, but the *creditworthiness assessment* should not be based solely on that plan.

5.2A.30 G (1) Where there are *customers* acting together as joint *borrowers*, the *firm* should consider whether it may be appropriate to carry out a *creditworthiness assessment* separately for each *customer* (as well as one for them together), having regard to the risk to that *customer* arising from the agreement were the *customer* to be treated as being solely responsible for obligations of the joint *borrowers* under the agreement.

- (2) Where the *borrower* is a *partnership* or one or more members of an unincorporated association acting as agent for other such members, the *partners* or members may be treated as a single *customer* for the purposes of the *creditworthiness assessment*.

Creditworthiness assessment where there is a guarantor

5.2A.31 R (1) This *rule* applies if, in relation to a *regulated credit agreement*:

(a) an *individual* other than the *borrower* (in this *rule* and *CONC* 5.2A.32G referred to as ‘the guarantor’) is to provide a guarantee or an indemnity (or both) (in this *rule* and *CONC* 5.2A.32G referred to as ‘the guarantee’); and

(b) the *firm* is required to undertake a *creditworthiness assessment* in respect of the *borrower*.

- (2) Before entering into the *regulated credit agreement* or significantly increasing the amount of *credit* provided under the agreement or significantly increasing a *credit limit* for *running-account credit* under the agreement, the *firm* must undertake a reasonable assessment of the potential for the guarantor’s commitments in respect of the agreement to have a significant adverse impact on the guarantor’s financial situation.

- (3) The *firm* must base the assessment under (2) on sufficient information:

- (a) of which it is aware at the time the assessment is carried out;

- (b) obtained, where appropriate, from the *borrower* or the guarantor, and where necessary from a *credit reference agency*; and

the information must enable the *firm* to carry out a reasonable assessment.

- (4) For the purposes of this *rule*, a guarantee does not include a *legal or equitable mortgage* or a *pledge*.

- 5.2A.32 G (1) The assessment of the guarantor does not need to be identical to the assessment undertaken in respect of the *borrower*, but should be sufficient in depth and scope having regard to the potential obligations which might fall on the guarantor.
- (2) If an increase in the amount of *credit* or in the *credit limit* is not itself significant but would result in there having been, since the last assessment under *CONC 5.2A.31R(2)*, a cumulative increase that is significant, then a further assessment of the guarantor is required.
- (3) In this *guidance*, references to payment refer to any payment under the guarantee (excluding any charge for non-compliance with the guarantee).
- (4) The *firm* should, when carrying out an assessment under *CONC 5.2A.31R(2)*, have regard to *CONC 5.2A.7G* to *CONC 5.2A.22G(1)* (excluding *CONC 5.2A.8R*, *CONC 5.2A.12R*, *CONC 5.2A.15G(4)* and *CONC 5.2A.19R(3)*), *CONC 5.2A.29G* and *CONC 5.2A.30G* but as if:
- (a) each of those provisions that is a *rule* were *guidance* and as if ‘should’ appeared in that *rule* instead of ‘must’ or ‘may’;
 - (b) references to ‘agreement’ are to the ‘guarantee’;
 - (c) subject to (g) below, the references to the *customer* or *borrower* are references to the ‘guarantor’;
 - (d) references to ‘repayments’ are references to ‘payments’;
 - (e) references to ‘repay’ are references to ‘pay’;
 - (f) references to the *creditworthiness assessment* are references to the assessment under *CONC 5.2A.31R(2)*;
 - (g) references in *CONC 5.2A.19R(2)(d)* and *CONC 5.2A.21G* to the *customer* are to the ‘guarantor’ as well as the *customer*; and
 - (h) the reference in *CONC 5.2A.19R(2)* to the factors listed in *CONC 5.2A.19R(3)* is to the factors listed in *CONC 5.2A.32G(5)*.

- (5) The factors to which the *firm* should have regard for the purposes of *CONC 5.2A.19R(2)* when deciding what steps should be taken to make the assessment under *CONC 5.2A.31R(2)* a reasonable one include each of the following :
- (a) the total potential liability of the guarantor under the guarantee;
 - (b) the duration (or likely duration) of the guarantee;
 - (c) any other costs, including any charge for non-compliance with the guarantee, which will or may be payable by or on behalf of the guarantor in connection with the guarantee; and
 - (d) any other potential adverse consequences for the guarantor arising under the guarantee from a failure to make a payment by the due date.
- (6) Key factors that will affect the level of affordability risk arising out of the guarantee include the total potential liability under the guarantee in absolute terms and relative to the guarantor's financial circumstances, where known.
- (7) The provision of the guarantee, and the reasonable assessment of the guarantor under *CONC 5.2A.31R(2)*, do not remove or reduce the obligation on the *firm* to carry out a reasonable *creditworthiness assessment* of the *borrower*. *Firms* are reminded of the *rule* in *CONC 5.2A.12R* that, in considering affordability risk for the *borrower*, a *firm* must not take into account the existence of (or the intention to provide or request the provision of) any guarantee or indemnity or other form of *security*.

Policies and procedures for creditworthiness assessment

5.2A.33 R A *firm* must:

- (1) establish, implement and maintain clear and effective policies and procedures:
 - (a) to enable it to carry out reasonable *creditworthiness assessments* or assessments under *CONC 5.2A.31R(2)*; and
 - (b) setting out the principal factors it will take into account in carrying out *creditworthiness assessments* or assessments under *CONC 5.2A.31R(2)*;
- (2) set out the policies and procedures in (1) in writing, and (other than in the case of a *sole trader*) have them approved by its *governing body* or *senior personnel*;
- (3) assess and periodically review:

- (a) the effectiveness of the policies and procedures in (1); and
 - (b) the *firm's* compliance with those policies and procedures and with its obligations under *CONC 5.2A*;
- (4) in the light of (3), take appropriate measures to address any deficiencies in the policies and procedures or in the *firm's* compliance with its obligations;
- (5) maintain a record of each transaction where a *regulated credit agreement* is entered into, or where there is a significant increase in the amount of *credit* provided under a *regulated credit agreement* or a *credit limit* for *running-account credit* under a *regulated credit agreement*, sufficient to demonstrate that:
- (a) a *creditworthiness assessment* or an assessment under *CONC 5.2A.31R(2)* was carried out where required; and
 - (b) the *creditworthiness assessment* or the assessment under *CONC 5.2A.31R(2)* was reasonable and was undertaken in accordance with *CONC 5.2A*,

and so to enable the *FCA* to monitor the *firm's* compliance with its obligations under *CONC 5.2A*; and

- (6) (other than in the case of a *sole trader*) establish, implement and maintain robust governance arrangements and internal control mechanisms designed to ensure the *firm's* compliance with (1) to (5).

5.2A.34 G *Firms* are reminded of the *guidance* on record-keeping in *SYSC 9.1.4G* and *9.1.5G*.

Unfair business practices

5.2A.35 R A *firm* must not complete some or all of those parts of an application for *credit* under a *regulated credit agreement* intended to be completed by the *customer*, without the consent of the *customer* or unless the *customer* has been advised to check the application (and has had a full opportunity to do so) before signing the agreement.

5.2A.36 R A *firm* must not accept an application for *credit* under a *regulated credit agreement* where the *firm* knows or ought reasonably to suspect that the *customer* has not been truthful in completing the application in relation to information relevant to the *creditworthiness assessment*.

5.2A.37 G An example of where a *firm* ought reasonably to suspect that the *customer* has not been truthful may be that information supplied by the *customer* concerning income or employment status is clearly inconsistent with other information of which the *firm* is aware.

CONC 5.5 (Creditworthiness assessment: P2P agreements) is deleted in its entirety. The deleted text is not shown.

5.5 Creditworthiness assessment: P2P agreements [deleted]

After the deleted CONC 5.5 (Creditworthiness assessment: P2P agreements) insert the following new section. It is not shown underlined.

5.5A Creditworthiness assessment: P2P agreements

Application

- 5.5A.1 R Subject to *CONC 5.5A.2R*, this section applies to a *firm* with respect to *operating an electronic system in relation to lending* in relation to a *borrower* or a prospective *borrower* under a *P2P agreement*.
- 5.5A.2 R This section does not apply in relation to:
- (1) an agreement under which a *person* takes an article or articles in *pawn* and under the terms of the agreement:
 - (a) the *borrower's* total financial liability (including in respect of capital, interest and all other charges including any expenses of sale) is not capable of exceeding the true market value of the article or articles *pawned* by the *borrower*; and
 - (b) the effect of the passing of property in the *pawned* article or articles to the *person* under section 120 of the *CCA*, or of a sale of the article or articles under section 121 of the *CCA*, would, therefore, be (at the very least) to discharge the debt secured by the *pawn* and any other obligation to pay a sum of money under the agreement including any expenses of sale; or
 - (2) a current account agreement where:
 - (a) there is a possibility that the account-holder may be allowed to overdraw on the current account without a pre-arranged overdraft or to exceed a pre-arranged overdraft limit; and
 - (b) if the account-holder did so, this would be a *P2P agreement* (overrunning).
- 5.5A.3 G (1) This section contains *rules* and *guidance* that apply to a *person* operating an electronic system that facilitates *persons* becoming

lenders and borrowers under P2P agreements, in contrast to CONC 5.2A which applies to a lender engaged in consumer credit lending.

- (2) Where *CONC 5.2A* applies to a *lender*, and *CONC 5.5A* applies to the *person* operating the electronic system, each will be subject to a separate obligation to undertake a *creditworthiness assessment*. However, *firms* are reminded of *SYSC 8* which permits outsourcing of operational functions subject to certain requirements (and with the *firm* outsourcing functions remaining fully responsible for discharging all of its obligations under the *regulatory system*).

Interpretation

- 5.5A.4 R In this section, references to repayment refer to repayment of capital or payment of interest or other charges (excluding any charge for non-compliance with a *P2P agreement*) and references to a *borrower* include, where the context so allows, references to a prospective *borrower*.

Creditworthiness assessment

- 5.5A.5 R A *firm* must undertake a reasonable assessment of the creditworthiness of a *borrower* before:
- (1) a *P2P agreement* is made; or
 - (2) the amount of *credit* provided under a *P2P agreement* is significantly increased; or
 - (3) a *credit limit* for *running-account credit* under a *P2P agreement* is significantly increased.
- 5.5A.6 G If an increase in the amount of *credit* or in the *credit limit* is not itself significant but would result in there having been, since the last *creditworthiness assessment*, a cumulative increase that is significant, then a further *creditworthiness assessment* is required. This may be the case, for example, where a number of consecutive increases have been made over a period, none of which is significant when considered in isolation but the aggregate sum of which is significant.
- 5.5A.7 R A *firm* must base its *creditworthiness assessment* on sufficient information:
- (1) of which it is aware at the time the *creditworthiness assessment* is carried out;
 - (2) obtained, where appropriate, from the *borrower*, and where necessary from a *credit reference agency*, and
- the information must enable the *firm* to carry out a reasonable *creditworthiness assessment*.
- 5.5A.8 G *CONC 5.5A.20R* to *CONC 5.5A.24G* contain *rules* and *guidance* in relation to the factors that should be taken into account in an individual case when

deciding how much information is sufficient for the purposes of the *creditworthiness assessment*, what information it is appropriate and proportionate to obtain and assess, and whether and how the accuracy of the information should be verified.

- 5.5A.9 R *Rules and guidance* in this section apply in relation to carrying out a *creditworthiness assessment*.

The subject matter of the creditworthiness assessment

- 5.5A.10 R The *firm* must consider:

- (1) the risk that the *borrower* will not make one or more repayments under the agreement by the due date; and
- (2) the risk to the *borrower* of not being able to make repayments under the agreement in accordance with CONC 5.5A.11R (referred to as ‘affordability risk’ in this section).

- 5.5A.11 R The *firm* must consider the *borrower’s* ability to make repayments under the agreement:

- (1) as they fall due over the life of the agreement and, where the agreement is an *open-end agreement*, within a reasonable period;
- (2) wholly out of the *borrower’s* income, except to the extent that the *borrower* has indicated clearly an intention to repay (wholly or partly) using savings or other assets;
- (3) without the *borrower* having to borrow to meet the repayments;
- (4) without failing to make any other payment the *borrower* has a contractual or statutory obligation to make; and
- (5) without the repayments having a significant adverse impact on the *borrower’s* financial situation.

- 5.5A.12 R If the *borrower* intends to make repayments (wholly or partly) using savings or other assets, the *firm* must take into account:

- (1) the purpose for which the savings or assets are or will be held;
- (2) the likelihood of the savings or assets being available to make repayments under the agreement; and
- (3) any significant adverse impact on the *borrower’s* financial situation of using those savings or assets.

- 5.5A.13 R When considering affordability risk, the *firm* must not take into account the existence of (or the intention to provide or request the provision of) any guarantee or indemnity or other form of *security*.

The borrower's income and expenditure

- 5.5A.14 R (1) This *rule* applies unless:
- (a) the *firm* can demonstrate that it is obvious in the circumstances of the particular case that the *borrower* is able to make repayments in accordance with *CONC 5.5A.11R*, so as to make the actions described in (2) to (4) disproportionate; or
 - (b) the *borrower* has indicated clearly an intention to repay wholly using savings or other assets (see *CONC 5.5A.12R*).
- (2) The *firm* must take reasonable steps to determine the amount, or make a reasonable estimate, of the *borrower's* current income.
- (3) Where it is reasonably foreseeable that there is likely to be a reduction in the *borrower's* income:
- (a) during the term of the agreement; or
 - (b) in the case of an *open-end agreement*, during the likely duration of the *credit* (see *CONC 5.5A.25R*),
- which could have a material impact on affordability risk, the *firm* must take reasonable steps to estimate the amount of that reduction.
- (4) The *firm* must take account of the *borrower's* income it has determined or estimated in accordance with (2) and (3).
- (5) The *firm* may only take into account an expected future increase in the *borrower's* income where the *firm* reasonably believes on the basis of appropriate evidence that the increase is likely to happen during the term of the agreement or, in the case of an *open-end agreement*, during the likely duration of the *credit*.
- 5.5A.15 R (1) Except as set out in (2), the *firm* must not have regard, in considering affordability risk, to the income of any *person* other than the *borrower* (or *borrowers* in the case of joint *borrowers* who are or will be parties to the agreement). Where there is or may be a guarantee or indemnity in relation to the agreement, the *firm* must comply with *CONC 5.5A.32R*.
- (2) The *firm* may have regard to income from jointly-held savings or assets in so far as it is reasonable to expect such income to be available to the *borrower* to make repayments under the agreement.
- 5.5A.16 G (1) A *firm* that proposes to rely on the exception in *CONC 5.5A.14R(1)(a)* should keep in mind that the burden would be on the *firm* to demonstrate, if challenged, that the absence of a material affordability risk was obvious such as to make the process of determination or estimation of the *borrower's* income

disproportionate.

- (2) An estimate of the *borrower's* income may include a minimum amount or a range, provided that any assumptions on which the estimate is based are reasonable in the circumstances.
- (3) For the purpose of considering the *borrower's* income under *CONC 5.2A.14R*, it is not generally sufficient to rely solely on a statement of income made by the *borrower* without independent evidence (for example, in the form of information supplied by a *credit reference agency* or documentation of a third party supplied by the third party or by the *borrower*).
- (4) An example of where it may be reasonable to take into account an expected future increase in income would be a loan to fund the provision of further or higher education, provided that an appropriate assessment required by this section is carried out.

- 5.5A.17 R (1) This *rule*:
- (a) applies only where *CONC 5.5A.14R* also applies; and
 - (b) does not apply where the *firm* can demonstrate that it is obvious in the circumstances of the particular case that the *borrower's* non-discretionary expenditure is unlikely to have a material impact on affordability risk, so as to make the actions described in (2) to (4) disproportionate.
- (2) The *firm* must take reasonable steps to determine the amount, or make a reasonable estimate, of the *borrower's* current non-discretionary expenditure.
 - (3) Where it is reasonably foreseeable that there is likely to be an increase in the *borrower's* non-discretionary expenditure:
 - (a) during the term of the agreement; or
 - (b) in the case of an *open-end agreement*, during the likely duration of the *credit* (see *CONC 5.5A.25R*),
 which could have a material impact on affordability risk, the *firm* must take reasonable steps to estimate the amount of that increase.
 - (4) The *firm* must take account of the *borrower's* non-discretionary expenditure it has determined or estimated in accordance with (2) and (3).
 - (5) The *firm* may only take into account an expected future decrease in non-discretionary expenditure where the *firm* reasonably believes on the basis of appropriate evidence that the decrease is likely to happen during the term of the agreement or, in the case of an *open-end*

agreement, during the likely duration of the *credit*.

- 5.5A.18 G (1) Non-discretionary expenditure referred to in *CONC 5.5A.17R* includes payments needed to meet *priority debts* and other essential living expenses and other expenditure which it is hard to reduce to give a basic quality of life. It also includes payments the *borrower* has a contractual or statutory obligation to make, such as payment obligations arising under a *credit agreement* or a mortgage contract.
- (2) An analysis of the size of the *borrower's* debts compared to the *borrower's* income may therefore form part of the *creditworthiness assessment* where detailed analysis of this kind is proportionate to the individual circumstances of the case, having regard to the factors listed in *CONC 5.5A.20R*.
- (3) Non-discretionary expenditure includes expenditure for other *persons* whose financial obligations the *borrower* meets wholly or in part.
- (4) An estimate of non-discretionary expenditure may include a maximum amount or a range, provided that any assumptions on which the estimate is based are reasonable in the circumstances.
- (5) Where the *firm* can demonstrate that it is obvious that there is no material affordability risk and the exception from the requirement to determine or estimate the *borrower's* income therefore applies, the *firm* is similarly not required to determine or estimate the *borrower's* non-discretionary expenditure.
- 5.5A.19 G (1) For the purpose of considering the *borrower's* non-discretionary expenditure under *CONC 5.5A.17R*, the *firm* may take into account statistical data unless it knows or has reasonable cause to suspect that the *borrower's* non-discretionary expenditure is significantly higher than that described in the data or that the data are unlikely to be reasonably representative of the *borrower's* situation.
- (2) It is unlikely to be appropriate to place reliance on statistical data, for example, where the *firm* is aware, or ought reasonably to be aware from information in its possession, that the composition of the *borrower's* household, or the number of dependants that the *borrower* has, or the level of the *borrower's* existing indebtedness, differs significantly from that of the sample of persons on which the statistical data were based.

Scope, extent and proportionality of assessment

- 5.5A.20 R (1) The extent and scope of the *creditworthiness assessment*, and the steps that must be taken to satisfy the requirement that the assessment is a reasonable one, are dependent upon, and proportionate to, the individual circumstances of each case.

- (2) The *firm* must consider:
- (a) the types of information to use in the *creditworthiness assessment*;
 - (b) the content and level of detail of the information to use;
 - (c) whether the information in the *firm's* possession is sufficient;
 - (d) whether and to what extent it is appropriate to obtain additional information from the *borrower*;
 - (e) whether and to what extent it is necessary to obtain information from a *credit reference agency*;
 - (f) any other sources of information to use;
 - (g) whether and to what extent to verify the accuracy of the information that is used;
 - (h) the degree of evaluation and analysis of the information that is used; and
 - (i) the steps to take to determine or estimate the *borrower's* income or non-discretionary expenditure (where such a determination or estimate is required),

having regard to the factors listed in (3) where applicable to the agreement.

- (3) The factors to which the *firm* must have regard when complying with (2) and deciding what steps are needed to make the *creditworthiness assessment* a reasonable one include each of the following where applicable to the agreement:
- (a) the type of *credit*;
 - (b) the amount of the *credit* or, where applicable, the *credit limit*;
 - (c) the duration (or likely duration) of the *credit*;
 - (d) the frequency of the repayments;
 - (e) the amounts of the repayments;
 - (f) the *total amount payable*;
 - (g) the *total charge for credit* or the *cost of credit*;
 - (h) the *annual percentage rate of charge*;
 - (i) whether the rate of interest or any other charge (except any

charge for non-compliance with the agreement) is fixed or variable;

- (j) any other costs, including any charge for non-compliance with the agreement, which will or may be payable by or on behalf of the *borrower* in connection with the agreement; and
- (k) any other potential adverse consequences for the *borrower* arising under the agreement from a failure to make a repayment by the due date.

5.5A.21 G (1) The *firm* should also have regard to information of which it is aware at the time the *creditworthiness assessment* is carried out that may indicate that:

- (a) the *borrower* is in or has recently experienced financial difficulties (see *CONC* 1.3); or
- (b) the *borrower* is particularly vulnerable, for example because the *borrower* has mental health difficulties or mental capacity limitations (see *CONC* 2.10 and *CONC* 7.2).

5.5A.22 G The *firm* may have regard, where appropriate, to information obtained in the course of previous dealings with the *borrower* but should consider whether the passage of time could have affected the validity of the information and whether it is appropriate to update it.

5.5A.23 G (1) The volume and content of the information that must be taken into account, and the steps that must be taken (if any) to evaluate that information and confirm its validity, will depend on the level of affordability risk arising out of the agreement.

(2) Key factors that will affect that level of risk include the actual or potential cost of the *credit* and the *total amount payable* (or, where the *P2P agreement* is not a *regulated credit agreement*, the sum of the *cost of credit* plus the *credit limit* or the total sums made available under the *P2P agreement*, as well as any *advance payment*) in absolute terms and relative to the *borrower's* financial circumstances, where known. So, if, for example, the amounts of the repayments and the *total charge for credit* are low and there are no or minimal charges payable in respect of non-compliance with the agreement, the amount of information that is sufficient to support a reasonable *creditworthiness assessment* may be less than would be required in the case of more expensive *credit* or *credit* that is higher in amount or where it is known that the *borrower's* financial situation is such that the *credit* may be expected to have a more significant impact.

5.5A.24 G In relation to *CONC* 5.5A.23G(1), the level of affordability risk arising out of the agreement may be high where either:

- (1) the total value of the *borrower's* outstanding debts relative to the *borrower's* income is high; or
- (2) there is evidence reasonably to suggest that there is a high likelihood that the *borrower* will not make one or more repayments under the agreement by the due date.

Types of credit

- 5.5A.25 R In relation to an *open-end agreement*, the *firm* must make a reasonable assumption about the likely duration of the *credit* which should take into account:
- (1) the terms and conditions of the agreement;
 - (2) any pre-contractual disclosure and explanation given to the *borrower* under the *CCA* or *CONC*; and
 - (3) the *borrower's* intentions, where known to the *firm*.
- 5.5A.26 R In relation to *running-account credit*, the *firm* must:
- (1) assume the *borrower* draws down the entire *credit limit* (if any) at the earliest opportunity and repays by equal instalments over a reasonable period;
 - (2) make reasonable assumptions about likely further drawdowns and repayments over the likely duration of the *credit* (including over the period referred to in (1));
 - (3) not use the assumption that the *borrower* will only repay the amount necessary to meet the minimum repayment required each month or other payment period; and
 - (4) take reasonable steps to procure the *lender* under the *P2P agreement* to set the *credit limit* in the light of (1) to (3).
- 5.5A.27 G The effect of *CONC* 5.5A.26R(1) is that, where a *lender* under a *P2P agreement* proposes to significantly increase a *credit limit*, the *firm* should assume that the proposed higher *credit limit* is drawn down in its entirety at the earliest opportunity following the increase and repaid by equal instalments over a reasonable period that begins on the date of that drawdown.
- 5.5A.28 R If there is no *credit limit*, the *firm* must make a reasonable assumption about a maximum initial drawdown of *credit* for the purposes of *CONC* 5.5A.26R(1).
- 5.5A.29 G The *firm* should:
- (1) in considering the reasonable period in *CONC* 5.5A.26R(1), have regard to the typical time required for repayment that would apply to

a fixed-sum unsecured personal loan for an amount equal to the *credit limit* (or, where there is no *credit limit*, the assumed initial drawdown), taking into account the terms and conditions of a loan likely to be available to that *borrower* (whether from the *lender* under the *P2P agreement* or from another *lender*) and any other factors that the *firm* reasonably considers to be relevant; and

- (2) in considering what are reasonable assumptions in *CONC 5.5A.26R(2)*, have regard to typical drawdown and repayment patterns of *borrowers* under *P2P agreements* which it has facilitated, or of *borrowers* of that type generally, but should also consider any factors particular to the individual *borrower*, where known.

5.5A.30 G Where a *borrower* is borrowing for business purposes it may be reasonable to take into account the *borrower's* business plan, but the *creditworthiness assessment* should not be based solely on that plan.

5.5A.31 G (1) Where there are *borrowers* acting together as joint *borrowers*, the *firm* should consider whether it may be appropriate to carry out a *creditworthiness assessment* separately for each *borrower* (as well as one for them together), having regard to the risk to that *borrower* arising from the agreement were the *borrower* to be treated as being solely responsible for obligations of the joint *borrowers* under the agreement.

- (2) Where the *borrower* is a *partnership* or one or more members of an unincorporated association acting as agent for other such members, the members or *partners* may be treated as a single *borrower* for the purposes of the *creditworthiness assessment*.

Creditworthiness assessment where there is a guarantor

- 5.5A.32 R (1) This *rule* applies if, in relation to a *P2P agreement*:
- (a) an *individual* other than the *borrower* (in this *rule* and *CONC 5.5A.33G* referred to as ‘the guarantor’) is to provide a guarantee or an indemnity (or both) (in this *rule* and *CONC 5.2A.33G* referred to as ‘the guarantee’); and
- (b) the *firm* is required to undertake a *creditworthiness assessment* in respect of the *borrower*.
- (2) Before the *P2P agreement* is made or the amount of *credit* provided under the agreement is significantly increased or a *credit limit* for *running-account credit* under the agreement is significantly increased, the *firm* must undertake a reasonable assessment of the potential for the guarantor’s commitments in respect of the agreement to have a significant adverse impact on the guarantor’s financial situation.
- (3) The *firm* must base the assessment under (2) on sufficient

information:

- (a) of which it is aware at the time the assessment is carried out;
- (b) obtained, where appropriate, from the *borrower* or the guarantor, and where necessary from a *credit reference agency*; and

the information must enable the *firm* to carry out a reasonable assessment.

- (4) For the purposes of this *rule*, a guarantee does not include a *legal or equitable mortgage* or a *pledge*.

- 5.5A.33 G (1) The assessment of the guarantor does not need to be identical to the assessment undertaken in respect of the *borrower*, but should be sufficient in depth and scope having regard to the potential obligations which might fall on the guarantor.
- (2) If an increase in the amount of *credit* or in the *credit limit* is not itself significant but would result in there having been, since the last assessment under *CONC 5.5A.32R(2)*, a cumulative increase that is significant, then a further assessment of the guarantor is required.
 - (3) In this *guidance*, references to payment refer to any payment under the guarantee (excluding any charge for non-compliance with the guarantee).
 - (4) The *firm* should, when carrying out an assessment under *CONC 5.5A.32R(2)*, have regard to *CONC 5.5A.8G* to *CONC 5.5A.23G(1)* (excluding *CONC 5.5A.9R*, *CONC 5.5A.13R*, *CONC 5.5A.16G(4)* and *CONC 5.5A.20R(3)*), *CONC 5.5A.30G* and *CONC 5.5A.31G* but as if:
 - (a) each of those provisions that is a *rule* were *guidance* and as if ‘should’ appeared in that *rule* instead of ‘must’ or ‘may’;
 - (b) references to ‘agreement’ are to the ‘guarantee’;
 - (c) subject to (g) below, the references to the *borrower* are references to the ‘guarantor’;
 - (d) references to ‘repayments’ are references to ‘payments’;
 - (e) references to ‘repay’ are references to ‘pay’;
 - (f) references to the *creditworthiness assessment* are references to the assessment under *CONC 5.5A.32R(2)*; and
 - (g) references in *CONC 5.5A.20R(2)(d)* and *CONC 5.5A.22G* to the *borrower* are to the ‘guarantor’ as well as the *borrower*;

- (h) the reference in *CONC 5.5A.20R(2)* to the factors listed in *CONC 5.5A.20R(3)* is to the factors listed in *CONC 5.5A.33G(5)*.
- (5) The factors to which the *firm* should have regard for the purposes of *CONC 5.5A.20R(2)* when deciding what steps should be taken to make the assessment under *CONC 5.5A.32R(2)* a reasonable one include each of the following :
 - (a) the total potential liability of the guarantor under the guarantee;
 - (b) the duration (or likely duration) of the guarantee;
 - (c) any other costs, including any charge for non-compliance with the guarantee, which will or may be payable by or on behalf of the guarantor in connection with the guarantee; and
 - (d) any other potential adverse consequences for the guarantor arising under the guarantee from a failure to make a payment by the due date.
- (6) Key factors that will affect the level of affordability risk arising out of the guarantee include the total potential liability under the guarantee in absolute terms and relative to the guarantor's financial circumstances, where known.
- (7) The provision of the guarantee, and the reasonable assessment of the guarantor under *CONC 5.5A.32R(2)*, do not remove or reduce the obligation on the *firm* to carry out a reasonable *creditworthiness assessment* of the *borrower*. *Firms* are reminded of the *rule* in *CONC 5.5A.13R* that, in considering affordability risk for the *borrower*, a *firm* must not take into account the existence of (or the intention to provide or request the provision of) any guarantee or indemnity or other form of *security*.

Policies and procedures for creditworthiness assessment

- 5.5A.34 R A *firm* must:
- (1) establish, implement and maintain clear and effective policies and procedures:
 - (a) to enable it to carry out reasonable *creditworthiness assessments* or assessments under *CONC 5.5A.32R(2)*; and
 - (b) setting out the principal factors it will take into account in carrying out *creditworthiness assessments* or assessments under *CONC 5.5A.32R(2)*;
 - (2) set out the policies and procedures in (1) in writing, and (other than

in the case of a *sole trader*) have them approved by its *governing body* or *senior personnel*;

- (3) assess and periodically review:
 - (a) the effectiveness of the policies and procedures in (1); and
 - (b) the *firm's* compliance with those policies and procedures and with its obligations under *CONC 5.5A*;
- (4) in the light of (3), take appropriate measures to address any deficiencies in the policies and procedures or in the *firm's* compliance with its obligations;
- (5) maintain a record of each transaction where a *P2P agreement* is entered into, or where there is a significant increase in the amount of *credit* provided under a *P2P agreement* or a *credit limit* for *running-account credit* under a *P2P agreement*, sufficient to demonstrate that:
 - (a) a *creditworthiness assessment* or an assessment under *CONC 5.5A.32R(2)* was carried out where required; and
 - (b) the *creditworthiness assessment* or the assessment under *CONC 5.5A.32R(2)* was reasonable and was undertaken in accordance with *CONC 5.5A*,

and so to enable the *FCA* to monitor the *firm's* compliance with its obligations under *CONC 5.5A*; and
- (6) (other than in the case of a *sole trader*) establish, implement and maintain robust governance arrangements and internal control mechanisms designed to ensure the *firm's* compliance with (1) to (5).

5.5A.35 G *Firms* are reminded of the *guidance* on record-keeping in *SYSC 9.1.4G* and *9.1.5G*.

Unfair business practices

5.5A.36 R A *firm* must not complete some or all of those parts of an application for *credit* under a *P2P agreement* intended to be completed by the *borrower*, without the consent of the *borrower* or unless the *borrower* has been advised to check the application (and has had a full opportunity to do so) before signing the agreement.

5.5A.37 R A *firm* must inform the prospective *lender* under a *P2P agreement* where the *firm* knows or ought reasonably to suspect that the *borrower* has not been truthful in completing the application for *credit* under the *P2P agreement* in relation to information relevant to the *creditworthiness assessment*.

- 5.5A.38 G An example of where a *firm* ought reasonably to suspect that the *borrower* has not been truthful may be that information supplied by the *borrower* concerning income or employment status is clearly inconsistent with other information of which the *firm* is aware.

...

6 Post contractual requirements

6.1 Application

...

- 6.1.2 G (1) ~~CONC 6.2~~, CONC 6.5 and CONC 6.7 apply to *firms* with respect to *consumer credit lending*.

...

CONC 6.2 (Assessment of creditworthiness: during agreement) is deleted in its entirety. The deleted text is not shown.

6.2 Assessment of creditworthiness: during agreement [deleted]

15 Agreements secured on land

15.1 Application

...

- 15.1.9 G Before a *regulated credit agreement* secured on *land* is entered into:
- (1) the *firm* should consider the adequate explanations it should give to the *customer* under CONC 4.2; and
[Note: paragraph 3.1 (box) of *ILG*]
 - (2) the *firm* is required under CONC ~~5.2A~~ 5.2.2 R(1) to assess the potential for commitments under the agreement to adversely impact the *customer's* financial situation to carry out a *creditworthiness assessment*.
[Note: paragraphs 1.14 and 4.1 of *ILG*]

After CONC TP 8 (Other transitional provisions), insert the following new text. It is not shown underlined.

TP 9 Transitional provisions for amended creditworthiness assessments

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision coming into force
5.2A	CONC 5.2A.1R to CONC 5.2A.37G	R	Where before [coming into force date] an application for <i>credit</i> under a <i>regulated credit agreement</i> is made or an application for a significant increase in <i>credit</i> (or the <i>credit limit</i>) under such an agreement is made, a <i>firm</i> , as the case may be, may enter into the agreement based on the assessment required under CONC 5.2 or provide the increase in <i>credit</i> or the <i>credit limit</i> based on the assessment required under CONC 6.2.	From [coming into force date] to [one month later]	[coming into force date]
5.5A	CONC 5.5A.1R to CONC 5.5A.38G	R	Where before [coming into force date] an application for <i>credit</i> under a <i>P2P agreement</i> is made, the agreement may be entered into based on the assessment required under CONC 5.5.	From [coming into force date] to [one month later]	[coming into force date]

Appendix 2

Proposed FCA determination

Under the powers conferred upon the Financial Conduct Authority ("the FCA") by section 74(3) of the Consumer Credit Act ("the CCA"), the FCA, being satisfied that it would not be against the interests of debtors, hereby determines that with effect from [coming into force date] section 74(1)(c) of the CCA applies to every debtor-creditor agreement to finance the making of the following payments arising on, or connected with, the death of a person:

- (1) inheritance tax chargeable in the United Kingdom ("the UK") on the death of any person;
- (2) fees payable to a court:
 - (a) in England, Wales or Northern Ireland on an application for a grant of probate or letters of administration;
 - (b) in Scotland, in connection with a grant of confirmation; and
 - (c) in the UK, in an application for resealing of a Commonwealth or colonial grant of probate or of letters of administration; and
- (3) payments in England, Wales and Northern Ireland to a surety in connection with a guarantee required as a condition of a grant of letters of administration or payments in Scotland to a cautioner in connection with a bond of caution required as a condition of issuing a grant of confirmation;

under which the creditor is the Bank of England or a bank.

This determination is made subject to the following conditions:

- (1) that the creditor has informed the FCA in writing of its general intention to enter into agreements to which this determination applies;
- (2) that the interest due under the agreement be calculated on a daily, weekly or monthly basis on the outstanding balance shown on the account, or some lesser amount;
- (3) that in the event of repayment of the borrowing, the interest under the agreement is charged up to but not beyond the date of repayment;
- (4) that the debtor under the agreement is an individual acting in the course of his trade or profession.

In this determination the terms "**creditor**" and "**debtor**" shall have the meanings assigned to them respectively by section 189 of the CCA. The term "**bank**" has the same meaning as in FCA's Handbook.

