12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

15 October 2018

Dear CEO

AFFORDABILITY OF HCSTC LOANS

Firms should take prompt action to:

- **Assess their lending activity to determine whether creditworthiness assessments are compliant. If deficiencies are found firms should take remedial action to ensure on-going lending activity is compliant and consider whether proactive redress may be required; and**

- **Inform the FCA if they are unable (now or in the future) to meet their financial commitments because of any remediation costs.**

I am writing to you regarding the issues surrounding the increase in complaints about unaffordable lending (including complaints about a 'chain' of loans over an extended period) and to set out how we expect high-cost short-term credit (HCSTC) firms to manage the impact.

Firms' complaint-handling procedures should ensure that they can improve the way in which they handle complaints, in the light of relevant determinations by the Financial Ombudsman Service ('the Ombudsman') of complaints about the firm.

We note that the Ombudsman has recently published four examples of determinations of individual complaints about payday loans to illustrate its approach to the issues raised in those complaints (see: https://www.financial-ombudsman.org.uk/publications/technical.htm). If relevant, firms should take these examples of determinations into account as part of establishing their own effective procedures for complaints handling (see DISP 1.3.1R).

Where firms identify recurring or systemic problems in their provision of a financial service, which could include problems in relation to the carrying out of affordability assessments, the firms should ascertain the scope and severity of the consumer detriment that might have arisen, and consider whether it is fair and reasonable for the firm to proactively undertake a redress or remediation exercise, which may include contacting customers who have not complained. In this regard firms are reminded of the requirement in DISP 1.3.3R which requires firms to analyse the root causes of complaints and, if necessary, to correct such root causes, i.e. lending practices.

We also remind you that where the Ombudsman makes an award or direction, such as a requirement to reimburse customers, firms must comply promptly.

We expect firms to make appropriate provision for any remediation which may be required, including associated costs (for example, fees to the Ombudsman). If doing so calls into question your firm's ability both now and in the future to meet its financial commitments as they fall due, you must notify the FCA immediately.

We are also taking the opportunity to remind you of our requirements in respect of affordable lending. We expect the firm to review its current lending processes to ensure it is fully compliant with our rules in CONC. If the firm identifies that its processes do not comply, it should take appropriate steps to address this, which may include considering whether to cease lending until any contraventions are remedied. If the firm becomes aware or has information which reasonably suggests that there are significant breaches of our rules, it must inform the FCA immediately. The firm should explain what steps it plans to take to address the issue.

We would highlight in particular the risks in relation to repeat borrowing. These were flagged in our price cap proposals in CP14/10, in July 2014, in which we said that we were concerned that repeat borrowing could indicate a pattern of dependency on HCSTC that is harmful to the borrower. We noted that rigorous affordability assessments were key to avoiding harm in this area, and firms should ensure they are making responsible assessments of the sustainability of borrowing.

We have recently published a policy statement (PS18/19) with amended rules and guidance on assessing affordability in consumer credit. These come into force on 1 November. The new rules clarify our expectations, but they do not fundamentally alter the requirements that firms have had to comply with since we took over regulation of consumer credit in 2014. Firms will, though, need to review their policies and procedures, and how these have been implemented, to ensure that they are compliant, and can evidence this. They should also keep their policies and procedures under review to monitor compliance on an ongoing basis.

A summary of our new rules and guidance is in the Annex to this letter.

Yours faithfully,

Jonathan Davidson

Director of Supervision – Retail and Authorisations

ANNEX – OUR AFFORDABILITY REQUIREMENTS

Our current requirements on assessing creditworthiness (including affordability) in consumer credit are set out in CONC 5.2 and 5.3 (and CONC 6.2 in relation to credit increases).

In addition, there are rules and guidance in CONC 6.7 in relation to the refinancing of agreements, and in CONC 7 in relation to the treatment of customers in default or arrears. CONC 6.7.22G confirms that a firm should not enter into consecutive agreements for high-cost short-term credit (HCSTC) if the cumulative effect would be that the total amount payable by the customer is not sustainable.

PS18/19, published on 30 July, sets out our new CONC rules and guidance on assessing creditworthiness including affordability. These come into force on 1 November 2018, and clarify our expectations of firms, building on the current rules. As noted in CP17/27, we did not undertake a cost benefit analysis (CBA) in relation to the new rules as we concluded that any increase in costs for firms would be limited to those needed to bring the firm into compliance with the current regulatory regime, or would be of only minimal significance.

A key element of the new rules is an increased emphasis on adequate policies and procedures, and being able to demonstrate compliance if challenged.

What we expect of firms

As under the existing CONC rules, PS18/19 makes clear that lenders must undertake a reasonable assessment of creditworthiness, based on sufficient information, before entering into a regulated agreement or increasing significantly the amount of credit or the credit limit.

In particular, lenders must consider 'affordability risk' – which we define as the risk to the borrower of not being able to make repayments under the agreement in accordance with CONC 5.2A.12R. A firm must not make a loan unless it can demonstrate that it has, before doing so, undertaken a compliant creditworthiness assessment and had proper regard to the outcome of that assessment in making a judgement about affordability risk.

The lender must consider the customer's ability to make repayments out of income:

- without the customer having to borrow to meet the repayments
- without failing to make any other payment the customer has a contractual or statutory obligation to make, and
- without the repayments having a significant adverse impact on the customer's financial situation

The firm must take reasonable steps to establish or estimate the customer's income, *unless* it can demonstrate that it is obvious in the circumstances that the customer is able to repay in an affordable manner, in accordance with CONC 5.2A.12R. The firm must take into account any reasonably foreseeable likely reduction in income over the term of the agreement.

Where income is taken into account, the firm must also take reasonable steps to establish or estimate the customer's non-discretionary expenditure, *unless* it can demonstrate that it is obvious in the circumstances that this is unlikely to have a material impact on affordability

risk. The firm must take into account any reasonably foreseeable likely increase in non-discretionary expenditure over the term of the agreement.

CONC 5.2A.20R states that the extent and scope of a creditworthiness assessment, and the steps the firm must take to satisfy the requirement that the assessment is a reasonable one, will be dependent upon, and proportionate to, the individual circumstances.

In particular, the firm must consider the nature and content of information to use in the assessment, whether and to what extent to verify the accuracy of information, and the degree of evaluation and analysis of the information, having regard to relevant factors. These will include the type and amount of credit, the amounts of the repayments and any potential adverse consequences of non-payment. In particular, a more rigorous assessment may be needed, the higher the actual or potential costs of the credit and the total amount payable, in absolute terms and relative to the customer's financial circumstances where known.

The firm should have regard to information of which it is aware at the time of the assessment that the customer is in, or has recently experienced, or is likely to experience, financial difficulties, or is particularly vulnerable. Where the firm has regard to information from previous dealings with the customer, it should consider whether to update it.

This is in line with our current approach. For example, CONC 5.2.3G notes that the extent and scope of an assessment should be dependent upon, and proportionate to, relevant factors which may include the customer's financial position and their credit history, including any indications that the customer is experiencing or has experienced financial difficulties.

Where a customer has engaged in repeat borrowing over an extended period, this is likely to be relevant in assessing the level of affordability risk and deciding whether a more rigorous assessment may be needed, potentially involving additional data and/or verification.

Where further data or verification is needed, our rules are not prescriptive about the content of the data or the manner of the verification, provided that the firm can demonstrate they are sufficient, in light of the indicators of affordability risk in the individual case, to form the basis of a reasonable and proportionate creditworthiness assessment. However, when considering current income, it is not generally sufficient to rely on self-certification by the customer.

We make clear in PS18/19 that firms must establish, implement and maintain clear and effective policies and procedures to enable compliance with our rules. They must assess and periodically review the effectiveness of their policies and procedures, and the firm's compliance, and take appropriate measures to address any deficiencies identified.

Firms must also maintain a record of each transaction where a regulated credit agreement is entered into, sufficient to demonstrate that a creditworthiness assessment has been carried out and this was reasonable and in compliance with CONC. This must be sufficient to enable the FCA to monitor the firm's compliance.

While we recognise that that there will always be some loans that turn out to be unaffordable, for example because of the impact of unforeseen circumstances, firms maintaining effective policies and procedures in line with the above requirements should aim to eliminate lending that is predictably unaffordable, minimising the risk of financial distress to consumers.