FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square
London
E20 1JN

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

27th June 2022

Dear Chief Executive Officer

FCA Supervisory strategy for Mainstream Consumer Credit Lenders (MCCL) portfolio

We have reviewed the key risks of harm for MCCL firms, their consumers and the markets in which they operate as part of our Approach to Supervision. This follows on from our previous review, and our letter to you in December 2020. In this letter, we:

- Provide an updated view of the key risks that MCCL firms pose to their consumers and the markets in which they operate.
- Outline our expectations of MCCL firms, including how firms should be mitigating these key risks.
- Provide an overview of our supervisory strategy and programme of work to ensure that firms are meeting our expectations, and harms are being appropriately mitigated.

You and your Board should carefully consider the extent to which your firm presents such risks, and strategies that could be used to mitigate them. We expect firms to be able to demonstrate the steps being taken to address and mitigate the risks we cover in this letter.

Over the last two years our supervisory strategy for the MCCL portfolio has been dominated by coronavirus (Covid-19). This was a departure from our planned two year supervision strategy set shortly before the pandemic.

The Rising Cost of Living

Many consumers will feel the impact in their personal finances, but we are particularly concerned that consumers least able to bear the rises will be hardest hit. While the headline average inflation rate is at 9% and rising, the Institute of Fiscal Studies estimates that the poorest households may face average inflation rates as high as 14%. This is in the context of a quarter (27%) of the population having low financial resilience, a figure likely to increase over the coming months.

At the same time, we expect to see higher demand for credit, although rising interest rates, and lower disposable income, may make borrowing less affordable, or unavailable, for some. Firms will also see a wider group of consumers in financial difficulty, who will find it harder to pay their debts. Some of these consumers will be in vulnerable circumstances or may be experiencing financial difficulty for the first time. Firms need to remain alert to the changing situation of their customers and target their efforts in response

We are concerned that consumers in this portfolio who are facing financial stress may be more susceptible to the purchase of unsuitable products. We expect firms in this portfolio to consider how the cost-of-living crisis is likely to impact consumers and take the necessary steps to support consumers and mitigate harm. We expect you to support customers struggling with personal debt or showing signs of financial difficulty during this period, signposting them to debt advice charities.

As highlighted below it is important that your firm meets the standards set out in our Principles/Rules/Guidance and, in particular, that appropriate attention/resource is given to the treatment of those customers in vulnerable circumstances.

We consider that our Tailored Support Guidance (TSG) for mortgages, consumer credit and overdrafts which was issued to address exceptional circumstances arising out of coronavirus, is also relevant for borrowers in financial difficulties due to other circumstances such as the rising cost of living. Based on our rules, and Principles 6 and 7, it provides further guidance on our expectations of firms when supporting borrowers and providing tailored forbearance and debt help to those in financial difficulty. In addition, our Vulnerable Customer Guidance (VCG) sets out our view of what firms should do to comply with their obligations under our principles and ensure they treat customers in vulnerable circumstances fairly.

The cost-of-living crisis may affect firms' ability to respond to, recover and learn from operational disruptions. Like other firms, you should ensure you have robust governance arrangements that can effectively identify, manage, monitor and report the risks you may be exposed to such as sudden increases in the volume of consumer contacts and data protection and cyber resilience risks. You should consider different scenarios that may test your operations, to ensure that your internal processes and control mechanisms are adequate. As a regulator, we will continue to work with you and the financial services sector to monitor, manage and mitigate any harms to consumers due to the rising cost of living.

Our recently published Dear CEO letter outlines these points in greater detail.

FCA Business Plan and Strategy

In Our Strategy 2022 to 2025, we set out our vision and ambitions for the next three years. We also set out the consistent high-level outcomes we expect from financial services and the key strategic areas we will be focusing on. We have grouped our commitments into three areas:

- **reducing and preventing serious harm** – our focus is on protecting consumers from the harm that authorised firms can cause, including tackling fraud and poor treatment.
- **setting and testing higher standards** – we're focusing on the impact that authorised firms' actions have on consumers and markets. We expect all firms we regulate to adopt the same high standards, and have an open and cooperative approach.
- **promoting competition and positive change** – we want to use competition as a force for better consumer and market outcomes. We will support UK growth and innovation that serves our society, underpinned by widely recognised and respected high standards.

Our Business Plan explains our programme of work for this year to achieve this three-year strategy. It outlines the key work we will undertake to deliver these outcomes, how we will measure progress.

We published this Business Plan when the external environment is changing rapidly. The longer-term impact of Covid continues to be uncertain. Low levels of financial resilience and rising costs mean many people are at risk of serious financial problems. And this is happening against a backdrop of rising inflation and interest rates and major geopolitical uncertainty. The impact of these factors will be felt by consumers and firms over the coming year and beyond.

By focusing more on end outcomes, and working across sectors and markets, we are better able to respond to new issues and macroeconomic challenges. Our new, more adaptive approach to allocating resources and monitoring our performance will make us more agile and help us respond more quickly to market needs.

The Business Plan details the work we will carry out this year under each of the 13 commitments from the Strategy where we will focus our work.

Key Risks Of Harm To Customers, Our Expectations And Strategy

1. Treatment of borrowers who fall into financial difficulty

Against a backdrop of higher inflation and increasing interest rates we are likely to see an increase in customers facing difficult circumstances, personally and financially, in the coming year. Ensuring that customers in financial difficulty receive fair and appropriate support remains a key priority for the FCA.

We undertook a review of coronavirus linked forbearance and how mortgage and consumer credit firms had implemented our tailored support guidance. We published a report in March 2021. Following these initial interventions, we launched the Borrowers in Financial Difficulty project which is a comprehensive programme covering a range of retail lending products. The work comprises a number of workstreams including a series of short surveys of c500 firms, deeper dives into specific areas of harm with a smaller selection of firms and consumer research. Where we identify concerns, we will act. A further update was published in January 2022 that includes our findings so far and examples of good practices. We have also committed to publish our overall findings in the second half of 2022.

2. Inadequate assessment of affordability

In our December 2020 letter to firms with MCCL activities, we highlighted that we wanted to see that those who offer credit cards and loans have compliant approaches to creditworthiness and relending. We want lenders to help deliver outcomes that ensure consumers do not become over-indebted by being given credit they cannot afford, and affordable credit is available to smooth consumption. Our expectations have not changed. Firms should not be seeking to increase business by lowering the stringency of affordability checks, especially given the context of the wider economic background that currently prevails.

Previous work we have undertaken has highlighted some areas of potential concern around how firms carry out affordability assessments. Firms should consider the points below as they review their strategies for assessing affordability:

- **Application of reasonable and proportionate checks** – firms should be carrying out reasonable and proportionate checks on customers applying for credit, considering all the factors in CONC 5.2A.20R (3), having regard to the guidance in CONC 5.2A.21G to 5.2A.25G, and considering the level of risk posed to their customers. This means not using a standardised assessment of affordability applied generically across a broad customer base without regard to individual circumstances.

- **Assessing customer income** – where required, firms should be taking reasonable steps to determine or make a reasonable estimate to establish a customer’s income (CONC 5.2A.15R (2)) based on sufficient information (CONC 5.2A.20R). This is particularly important as an assessment of income is a necessary component in an affordability assessment. For example, we ask firms to consider the limitations of any income verification tools they use.

- **Assessing non-discretionary expenditure** - firms should take reasonable steps to comply with the requirements to determine the amount, or make a reasonable estimate, of the customer's non-discretionary expenditure, for example, housing costs, essential living expenses and child maintenance.

- **Performing the affordability calculation** - customers who are required to operate under extremely tight budgets or with an inconsistent income stream may not be resilient to income shocks; Firms are reminded of their obligations under CONC 5.2A.12(5) that repayments should not "have a significant adverse impact on the *customer's* financial situation".

- **Management information** (MI) – firms should monitor the effectiveness of their creditworthiness assessment policy and procedures and consider what MI and metrics they could use to help inform this. Affordability MI is lacking if it only monitors whether a customer can maintain minimum payments on credit card debts. Under CONC 5.2A.12R, the customer should not only be able to maintain obligations they have a contractual or statutory duty to make, but repayment of the credit should not have a significant adverse impact on the customer's financial situation.

In line with the FCA's objective to become a more data driven regulator, lenders' approach to assessing affordability is a key area where additional data may be sought. We will be monitoring the market for signs of inadequate affordability assessments.

3. Persistent debt strategies adopted are insufficient to enable customers to pay down their persistent debt within a reasonable time

In 2018 we introduced a package of measures to help customers in persistent credit card debt. Since the introduction of the rules, firms have been engaging with a significant number of customers in persistent debt to discuss the options available to them to pay down their debt within a reasonable period. This remains a priority risk for us and we will continue to review the effectiveness of these remedies.

4. Firms do not deal with their s75 Consumer Credit Act 1974 (CCA) responsibilities appropriately

The impact of Covid-19 has led to a changing economic environment which in turn has led to a growth in s75 CCA claims. A growing number of these lead to customer complaints, some of which are being upheld by the Financial Ombudsman. We have requested data from firms on this matter to review how these claims/complaints have been handled. We will review this data for evidence that firms have met and continue to meet their responsibilities. Where we have concerns, we will act.

Additional areas of interest

The following areas are of interest for the FCA, but we are not currently proposing *specific* pieces of work focused solely on these. We will continue to monitor for indicators of concern that point to possible customer harm, including where these impact on the risks identified above, and act where appropriate.

1. Changing ways of working and changes to business models potentially leading to poor customer outcomes

We are seeing firms explore different ways of working and changes to business models, some of which we recognise present opportunities for firms and may bring benefits to customers. Equally, we are also aware of the potential for customer harm.

We are increasingly seeing firms move towards more automated processes. The use of automated approaches can be helpful to customers, although further enhancements to some of the new digital processes we have seen would be beneficial. For example, clear signposting of non-digital support and recognising where customers are in vulnerable circumstances. Our Coronavirus-linked-forbearance-key-findings provides examples of automated processes that could be helpful to customers.

Similarly, we are seeing more examples of firms seeking to use Open Banking (OB) as a means of assessing customers' ability to afford a loan. OB introduces innovation to the market and potentially increases firms' confidence in the ability to predict customers' likelihood and capability to repay. Nevertheless, we are concerned that it may result in a firm placing an overreliance on OB data or failing to consider how other data or sources of information should be used alongside OB to provide a more holistic picture of the customer's situation. We will continue to monitor developments in the use of non-traditional data items e.g. OB and social media, as a way of assessing customers' financial circumstances.

New products have been developing, most notably, Buy Now Pay Later (BNPL). BNPL is a product that can have important benefits for consumers as the sector develops and becomes more widespread, but it also carries risks and the potential for harm. The Government announced plans and has issued a consultation paper on the proposed regulatory framework for BNPL products. Once the Government has decided on the scope of activities and firms to be regulated we will follow with our own consultation on the relevant FCA rules, to set clear standards for firms.

In the current economic environment, we see the potential for consumers whose circumstances can make them vulnerable or otherwise disengaged, to make mistakes with what can be complex financial products. Firms should seek to help consumers make informed and effective decisions by providing high levels of transparency about the credit products offered.

2. Governance and oversight - Third party oversight arrangements

Where firms use third party {arrangements\administrators (TPA)}, they should ensure appropriate oversight is in place to comply with applicable rules and guidance on outsourcing (Senior Management Arrangements, Systems and Controls (SYSC) and Consumer Credit sourcebook (CONC). This should include ensuring appropriate outcomes for customers arising from the actions of those TPAs. These outcomes remain the responsibility of the lender. The Senior Manager(s) responsible for the oversight of your TPA's activities should have this included in their Statement of Responsibility. We will hold them to account where we find breaches of our rules, including a failure to take reasonable steps to prevent misconduct.

3. Data-led regulation

As we transition towards becoming a more data-led regulator (see the FCA data strategy), we will increase our focus on data, not limited to regulatory returns. The data we receive from firms helps inform us on potential for harm and identify areas where supervisory resource should be allocated. Our transition towards automated data collection should enable firms to meet their reporting requirements and submit returns more easily.

Principle 11 includes a requirement for firms to deal with its regulators in an open and co-operative way, this encompasses co-operating wherever possible with respect to ad-hoc information requests, such as surveys. Further to this, we expect all firms in this portfolio to be aware of the requirements and guidance in SUP 15, and to submit notifications as required. This should be when an issue or event is *identified*, and firms should not wait until resolution to notify us.

Failure to notify us of matters set out in SUP 15.3 could have serious regulatory impact as it may impact our ability to effectively supervise the firm and raise questions on whether the firm is meeting the Effective Supervision Threshold Condition (COND 2.3 Effective Supervision).

Data enables us to make better, more informed regulatory decisions that benefit consumers and firms alike. We are committed to using the data that we receive from firms to test whether their products and services deliver good outcomes for consumers, and to simulate policy outcomes before publishing rules. Equally, we want to share our data with firms so they can use it to test new products and business models themselves. To be an effective regulator, we must respond to today's challenges and prepare for those of tomorrow. Our new data strategy will be published in the coming months, which aims to make us more effective by harnessing data, converting it into actionable intelligence and improving our real time understanding of what's currently happening and, crucially, of emerging risks.

Raising Standards

We are proposing to introduce a new 'Consumer Duty', that would set a higher standard of care that firms should provide to consumers in retail financial markets. The Consumer Duty would require firms to act to deliver good outcomes for customers (including those in vulnerable circumstances). This reflects the positive and proactive expectation we have of firm conduct, and our desire for firms to think more about consumer outcomes and place consumers' interests at the heart of their activities.

Amongst other things, it would require firms to focus on supporting their customers to make good financial decisions (including those in vulnerable circumstances) and avoiding foreseeable harm and checking whether their customers are getting good outcomes. This includes providing information consumers can understand, products and services that are fit for purpose and offer fair value and helpful customer service. A firm would, for example, not be acting in accordance with the Consumer Duty where it seeks to exploit customers lack of knowledge, understanding or behavioural biases.

Exploitation and misleading information are counterproductive and detrimental to a healthy financial services system and are the types of poor practices the Consumer Duty seeks to prevent.

Our second consultation with specific rules and guidance on the proposed new Consumer Duty is now closed and pending the outcome of this consultation, we expect any new rules and guidance to be published by the end of July 2022.

Fair Treatment of Consumers with vulnerable characteristics

Consumers may be at greater risk of harm if they have characteristics of vulnerability, which may limit their ability or willingness to make decisions and choices or to represent their own interests. As set out in our Guidance for firms on the fair treatment of vulnerable consumers, firms should pay particular attention to the needs of these consumers. All firms in the portfolio should achieve good outcomes for consumers with vulnerable characteristics. Firms should do this by understanding their target market/customer base, having staff with appropriate skills and capability to recognise and respond to the needs of these consumers, respond to consumer needs throughout product design and monitor and assess whether they are meeting the needs of consumers with vulnerable characteristics.

The fair treatment of consumers with characteristics of vulnerability is at the core of the FCA's Business Plan. Ensuring fair and good outcomes for all market participants, especially those in vulnerable circumstances, should be woven into the business models, cultures, policies, and processes of all the firms we regulate.

Environmental, Social and Governance (ESG) strategy

Financial services and markets have a central role in the transition to a low carbon economy and a more sustainable future. The Government has committed to achieving a net zero economy by 2050. We will support the financial sector in driving positive change, including the transition to net zero. We have developed a refreshed ESG Strategy, which sets out our target outcomes and the actions we expect to take to deliver these.

Firms in the portfolio should play their part in helping the economy adapt to a more sustainable long-term future. Ultimately, a firm's own governance and culture will be critical drivers and enablers of its performance on environmental and climate matters. Since wider environmental and social matters are increasingly central to economic and financial decision making, our work too must encompass ESG considerations beyond climate change.

Firms processing and storing large amounts of data in their data centres that are part of a group listed in the UK should also take note of FCA policy statements confirming new climate-related disclosure requirements for premium and standard listed companies **(PS20/17 and PS21/23).**

Diversity and inclusion is a key component of ESG – both in its own right, and as an enabler of creative solutions to other environmental and social challenges. As set out in DP21/2, having staff and Board members from diverse background and experiences contributes to this. Diversity and inclusion in regulated firms is a priority for us, and DP21/2 (which closed on 30 September 2021) and the accompanying Literature Review started the conversation on what more can be done to improve diversity and inclusion in financial services and set out the links we see between D&I and conduct risks. We shall be consulting on rules and guidance to promote diversity and inclusion in the financial services sector in 2022.

What we expect from you

All firms in the financial services industry are expected to conduct their activities in a way that treats consumers fairly, provides clear communications to consumers, resolves disputes and complaints fairly, and that complies with our Principles and the FCA Handbook rules and guidance. We expect you to reflect on the issues highlighted in this letter to challenge how your firm operates.

Contact

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

However, there may be times when your firm faces urgent issues of strategic importance. If this happens, please contact the Head of Department, Caroline Gardner on 020 7066 8186 or Caroline.Gardner@fca.org.uk, alternatively please contact one of my Managers, Patrick Brien on 020 7066 1086.

In 2024 we will write again with an updated view of the key risks in the portfolio and our supervisory plans for the next cycle.

Yours sincerely,

David Raw
Co-Director, Consumer & Retail Policy Division
Supervision, Policy & Competition Division