FINANCIAL CONDUCT AUTHORITY

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6 October 2022

Dear Chief Executive Officer,

Re: FCA strategy for firms providing high-cost lending products ("high-cost firms")

This letter sets out our updated view on the key risks of harm we believe high-cost firms pose to their customers and the markets in which they operate. You should consider the degree to which your firm presents such risks and take the necessary steps to mitigate them. We also set out our strategy for this portfolio to ensure that firms understand our focus, expectations of them and the related actions in order to manage their risks and reduce harm to consumers.

It is particularly important, with the rising cost of living and increasing risk of financial hardship for consumers, and of consumers facing difficulties repaying debt, that firms proactively take steps to manage and mitigate the risk of poor consumer outcomes and provide the appropriate assistance to customers.

High-cost firms need to start preparing for implementation of our Consumer Duty, which becomes effective from 31 July 2023. We will be supporting the industry with its implementation between now and then; following which we will assess how firms demonstrate they are meeting their updated obligations.

The rising cost of living

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 set out our expectations of firms and how they should support consumers as they feel the impact of the rising cost of living in our letter to CEOs of lenders dated 16 June 2022.

We expect you and the firm's management to be able to demonstrate the steps you have taken to address the risks we cover in both this letter and the letter of 16 June 2022.

For example, 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.

We are concerned that consumers in this portfolio who are facing financial stress may be more susceptible to purchasing unsuitable products. We wrote to credit brokers and high-cost firms in May 2022 about action that needs to be taken to ensure your financial promotions are clear, fair and not misleading.

The current and forecast economic environment may give rise to increased operational risks. You should ensure you have robust governance arrangements and the ability to identify, monitor and manage the operational risks your firm may be exposed to on an ongoing basis.

Raising standards: Our Consumer Duty

You will be aware that we have introduced a 'Consumer Duty', that sets a higher standard of care that firms should provide to consumers in retail financial markets.

You will need to apply the Consumer Duty to new and existing products and services that are open to sale (or renewal) from 31 July 2023. We have given firms longer, until 31 July 2024, to apply the Duty to products and services held in closed books. By the end of October 2022, firms' boards or senior leadership should have agreed high-level implementation plans. These do not need to be detailed analysis of the full Consumer Duty and how firms will implement it, but it should provide the framework under which firms will act to meet the deadline. We will be providing firms with further information regarding the Consumer Duty prior to the implementation deadline.

The Consumer Duty will 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.

The Consumer Duty sets a higher, clearer standard and will require firms to focus on supporting their customers to make good financial decisions, 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. As we set out below, we consider there to be existing drivers of harm in this portfolio in several of the areas of focus for the Consumer Duty, which has led us to prioritise this portfolio for assessing implementation of the Consumer Duty requirements in firm practices.

We expect the focus on acting to deliver good outcomes to be at the centre of high-cost firms' strategy and business objectives.

High-cost firms will need to consider in their implementation of the Consumer Duty and setting or re-setting their strategy and business objectives, how their business is delivering the outcomes that the Consumer Duty supports:

• Fair value: consumers receive fair prices and quality. We will be looking to high-cost firms to demonstrate what fair value means in relation to their products and policies. Fair value is not limited to price. Value needs to be considered in the round, to ensure that the price the customer pays is reasonable compared to the overall benefits the product provides. More detail about the fair value outcome is at Chapter 7 of the guidance.

• Suitability and treatment: consumers receive suitable products and services and receive good treatment.

• Confidence: consumers have strong confidence and levels of participation in markets.

• Access: diverse consumer needs are met.

Portfolio and Consumers

Firms that operate in this portfolio vary significantly in size, business model and products that are offered. However, many consumers within this market share similar characteristics, for example, they may be financially vulnerable and therefore more likely to be affected by the rising cost of living.

The period since our last portfolio letter has seen a change in the shape of the market with a number of firms facing significant challenges as a result of poor historical lending practices. We estimate that new lending in the high-cost credit market has halved since 2018-19, with significant contraction in high-cost-short-term credit, rent-to-own, guarantor and home collected credit lending.

While supply has reduced in this portfolio, we expect consumer demand for credit to continue at a time when individual consumers' financial circumstances may be changing. In this environment, it is important that firms offering credit, do so responsibly. Consumers should be able to understand and afford their credit products.

We have seen some firms' complete reviews of their creditworthiness assessment policies and resume lending with higher standards. We expect firms to maintain these higher standards and lend responsibly and provide appropriate forbearance to consumers who are in financial difficulty. We will continue to work with firms in order to remediate their approach to lending and conduct past business reviews where there is evidence of systematic historical irresponsible lending.

We recognise that as standards improve, in particular in relation to firms' assessment of creditworthiness, this may result in some groups of consumers' credit needs no longer being served by firms in the portfolio. We will continue to work with government and relevant partners to enable strategies to be developed to help meet the needs of these consumers.

Our focus

Our aim is that there is a sustainable and effective high cost lending market which serves customers well. To achieve this, we will continue to seek to raise standards across the market including through implementation and supervision of firms under our Consumer Duty. We will look to increase our industry-level engagement to make sure our expectations are clear and to be available to hear from the firms we regulate in this portfolio.

We will be looking at how high-cost firms are governed and oversee their regulated activities, including the role Boards (where relevant) and Senior Managers play in this process. During the implementation period, firms should expect us to ask them to share their approach for the Consumer Duty. We may also ask firms to demonstrate how they are using effective controls to prevent harm and improve consumer outcomes.

Below we set out key elements of the consumer journey that will be a focus of our supervisory work for the next 3 years.

We will support firms with implementing the Consumer Duty then start to review the effectiveness of that implementation. As part of this we will ask firms to consider and act on what "fair value" means for their customers.

We will continue to focus on responsible lending, particularly

- regarding how firms promote and describe their products and the information they give customers;
- on firms' approach to affordability including creditworthiness assessments; and
- sustainable borrowing for consumers.

We will also continue to focus on the treatment of borrowers in financial difficulty.

We will look for improvement in root cause analysis on upheld complaints by firms to improve their processes and where necessary address the drivers of those complaints.

We will bring more focus in our supervision of firms to how Senior Managers execute their roles and the oversight of firm's activities by their Boards.

Our views of the key drivers of harm and our expectations of firms

Financial pressure is building for consumers, with increasing living costs reducing disposable income. As such, it is important that firms take action now in accordance with our Principles, Rules and Guidance to mitigate the risk of harm to consumers.

We recognise the role high-cost firms played during the pandemic with the swift implementation of the payment deferral guidance. We consider that our Tailored Support Guidance (TSG) which was issued to address exceptional circumstances arising out of the pandemic , 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.

Our updated view of the key drivers of harm encompasses harms we have highlighted in previous communications. Firms should not assume that they are compliant but regularly consider and assess which of the drivers of harm are relevant to their business and take any necessary steps to address issues without waiting for regulatory intervention (in line with SYSC 6.1.1.R and SYSC 6.1.3A.G

We expect firms' culture and governance to drive good behaviours and produce fair outcomes that are likely to benefit consumers and markets, and for individuals to be accountable for their actions. We want Boards and senior management in firms to prioritise embedding a healthy culture, one with meaningful purpose reflected in their policies and decision-making aligned with consumer interests and outcomes at the heart of their business. We have seen failings that can often be traced back to weaknesses in governance and senior manager accountability. Poor governance and senior manager oversight has been observed as a root cause behind several of the drivers of harm we set out below.

Firms' designated Senior Managers (who serve in Senior Manager Functions) are reminded that they are responsible for ensuring that their firms are acting in accordance with our Principles, rules and guidance and that they are accountable for their firms' conduct. Together, the Senior Managers and Directors should be driving the right culture.

Where we identify harms caused by poor firm conduct, we will likely expect a comprehensive past business review to determine the remediation action required.

1. Sludge practices

Consumers should be able to clearly understand the product they are applying for and have a clear expectation of what happens through the life of the product. Relevant, consistent and accurate information should be easily accessible and should not be unnecessarily set out in multiple documents or clicks/links to access. Our guidance on the Consumer Duty sets out our findings on a range of firms' increasing use of Sludge Practices (p99). This is an example of poor firm culture; it is expected that you and the management team take the lead to remove such practices from your firms and drive better consumer outcomes.

2. Affordability and relending

High-cost credit consumers are more likely to display characteristics of vulnerability, low financial resilience and poor credit histories. They often hold multiple credit products and juggle repayments, sometimes having to decide which priority debts to pay when they don't have enough for all. We have significant concerns that firms do not consider when repeat borrowing behaviour may be indicative of underlying financial difficulties and that a more rigorous creditworthiness assessment is required.

In addition, we expect firms not to encourage refinancing of credit agreements if the result would be that the customer's commitments are not sustainable. We also expect firms to only agree to refinance if they reasonably believe that it is not against the customer's best interests to do so.

Our experience in supervision work shows that firms' assessments of creditworthiness are frequently inadequate, especially when relending. Firms have an obligation to ensure lending and relending is done affordably and responsibly. Failure to do so is the biggest cause of complaints and subsequent redress, which has led to firms failing.

3. Forbearance

In March 2021 we commenced a review of how lending firms, including firms in this portfolio, treat borrowers who are in financial difficulty. In our letter of 16 June 2022 we shared the emerging findings from our extensive programme of work looking at this. This included examples of behaviour that results in poor outcomes for borrowers and our expectations of lenders when supporting borrowers in financial difficulty. We expect firms to have already considered the content of the letter, taking early action where necessary, and to do the same again when the detailed findings are published later this year.

4. Complaint handling

We remain concerned about the quality of firms' complaint handling, especially complaints about affordability and relending. We have seen evidence to suggest that firms are failing to fully consider the DISP rules when dealing with complaints. For example, not taking the outcome of previous complaints into account when handling new complaints, not undertaking root cause analysis to ensure any process or control failings do not recur, and not adequately recording senior management decisions and documenting the decision making process.

Firms should be targeting an overall reduction in complaints and reducing the number of complaints referred to and upheld by the Financial Ombudsman Service. As firms undertake their own root cause analysis and where they find systemic issues, they should inform the FCA of their intention to undertake a review of their historical lending.

Innovation

We encourage innovation in this market and offer a range of market facing tools and initiatives to support innovative firms to launch new products and services. We recognise that firms may make changes to their business models which are innovative and new firms with new business models may enter the market. We shall monitor and review these as they emerge to understand the potential drivers of harm within each.

Firms offering new products will need to consider their regulatory obligations under Principle 11 and will be expected to take into consideration the concerns set out in this letter and, once the Consumer Duty takes effect, demonstrate the consumer outcomes they are achieving.

Fair Treatment of Consumers with vulnerable characteristics

On 23 February 2021 we published our findings from our work with retail banks on how they have implemented the Vulnerable Customer Guidance. Firms should consider and act on our Guidance for firms on the fair treatment of vulnerable consumers, and also consider if the findings from the Retail Bank implementation review are relevant to your firm and learnings can be taken from this.

Environmental, Social and Governance (ESG) strategy

Financial services and markets also have a central role in the transition to a low carbon economy and a more sustainable future. We have developed a refreshed ESG strategy setting out our target outcomes and the actions we expect to take to deliver these in the coming months, spanning over all of our work on sustainability and climate change.

Our joint discussion paper with the PRA and the Bank of England dives deeper into our thoughts on accelerating meaningful change in diversity and inclusion

What we expect from you

Firms should regularly assess their activities to ensure they remain appropriate and consistent with our principles, relevant FOS decisions, and reflect the changes in economic factors such as the cost of living. This should result in lower complaints, fewer upheld complaints by both the firm or FOS and potentially less accounts requiring forbearance.

We expect you to reflect on the risks, issues and upcoming regulatory changes highlighted in this letter to proactively assess how your firm operates and put in place the necessary actions.

Principle 11 requires 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 a material issue or event is identified, and the firms plan to resolve the matter. Failure to notify us of matters set out in SUP 15.3 could have serious regulatory impact and raise questions on whether the firm is meeting the Effective Supervision Threshold Condition (COND 2.3 Effective Supervision).

Contact

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. You can also email us at firm.queries@fca.org.uk.

However, there may be times when your firm faces urgent issues of strategic importance. If this happens, please contact the Martha Stokes, Head of Department, on 020 7066 0894 or Martha.Stokes@fca.org.uk, or Emma Davies, Manager, on 020 7066 0650 or Emma.Davies@fca.org.uk.

Yours sincerely

Roma Pearson
Director, Consumer Finance
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