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20 March 2024

Dear Chief Executive Officer,

FCA strategy for Consumer Lending

The Consumer Lending market is essential to the UK economy, providing a vital service for consumers, including millions in vulnerable circumstances. In this letter we focus on three portfolios in the Consumer Lending market: **High-Cost Lending, Mainstream Consumer Credit Lending and Credit Unions**. When we refer to 'Consumer Lending' throughout this letter, we are only referring to these portfolios.

Previously we have sent different letters to firms in each portfolio. We note the number of similarities in products, consumer base and potential harms posed. We have therefore chosen to assess these three portfolios as a group to share a market-level view with you through this letter.

We want to support a thriving and innovative Consumer Lending market, where consumers have access to credit which is affordable for them. We seek to support the growth of an affordable and safe credit market through increased firm and trade body engagement, to share and encourage better practice, and supporting innovation through steps such as the Regulatory Sandbox, Innovation Pathways and TechSprints. For firms which embrace change and innovation, it is important they do so safely to identify and manage the risks. The market works well when we see firms lending affordably and sustainably, mitigating the risk of poor consumer outcomes, and providing appropriate assistance to consumers facing financial hardship.

However, too often we find significant failings. For example, over the last two years we have taken supervisory action against firms where we have seen:

- Inadequate creditworthiness assessments
- Firms relying on relending to sustain business models
- Firms providing products that are designed to promote persistent use
- Inadequate support and forbearance options offered for consumers in financial difficulty
- Ineffective complaints management processes
- Firms failing to meet redress liabilities as they fall due.

This letter sets out our updated view on the key risks of harm we believe Consumer Lending firms may pose to their consumers and the markets in which they operate. This will shape our focus and engagement with the Consumer Lending market over the next two years.

You should discuss this letter with your firm's Board or Governing Body and be able to demonstrate the steps you have taken to address the risks covered in this letter.

The Consumer Lending Market

Consumer Lending firms vary significantly in size, business model and product offering. However, a growing number of consumers within these markets share similar characteristics; for example, they may be financially vulnerable and therefore more likely to be affected by cost of living pressures, higher interest and inflation rates. As the economic situation evolves and consumers' personal circumstances change, they may also need to access different financial products.

Since we last wrote to you in 2022, we have seen further change in the Consumer Lending market. There has been a significant contraction within high-cost lending since 2019, which has continued since 2022, but at a slower rate. Whilst supply of high-cost credit has reduced, overall demand for consumer credit has increased. We have seen growth in use of pawnbrokers with new lending up by £100m since 2019 and credit card borrowing has started to grow post pandemic. Although the number of credit union firms have decreased, we have seen member numbers grow and new lending increase by £500m since 2021.

Whilst not at pre-pandemic levels, borrowing is increasing with total lending in the Consumer Lending market having grown by £6.5bn from £112bn to £118.5bn between June 2021 and June 2023. At the same time, consumers are experiencing higher annual interest rates on credit card and personal loans, which will have an impact on existing repayments and the affordability of any future credit. We expect demand for credit to continue to rise at a time where consumers may already be struggling with other financial pressures.

Our Priorities

We want to support a sustainable and effective Consumer Lending market in which consumers who can afford to borrow, have access to credit that meets their needs. Firms offering credit must do so responsibly.

Our market-wide strategic objective under the Financial Services and Markets Act (FSMA) is to ensure that the relevant markets function well. To achieve this, we have three key focus areas:

- **Reducing and preventing serious harm**
- **Setting and testing higher standards**
- **Promoting competition and positive change**

In conjunction with the above, we have identified our Consumer Lending specific market priority harms below, which apply to firms across all three portfolios. Our supervisory programme will focus on these harms closely over the next two years.

<u>Promoting competition and positive change</u>

1. Access to Affordable Credit

Access to affordable credit allows consumers to manage their money and deal with short-term or unexpected cash flow issues. A well-functioning market provides healthy competition, products and services that meet consumers' needs, offers fair value, and supports consumers to achieve their financial goals. Within that market, firms need to treat consumers fairly, lend affordably and support consumers in difficulty.

For some consumers, credit will not be the right answer. Access to *unaffordable* credit is harmful to consumers' financial and personal wellbeing. In instances where prospective consumers are declined credit, we expect firms, as set out in the Consumer Duty guidance, to provide other forms of support. Ineffective management of declined credit can increase the risk of consumers going to illegal money lenders as they may not be aware of alternative options. Our 2022 Financial Lives Survey (FLS) shows that illegal money lending is on the rise with at least 200,000 households stating they had borrowed from an illegal lender over the prior 12 months.

Firms should consider ways they can support declined consumers. For example, signposting to a third party that provides reliable and relevant information and/or to Money Helper. We have seen instances of good practice already, for example credit union firms who have integrated a 'benefits calculator' link on their websites, aiming to assist consumers in securing the financial support to which they are entitled.

Supporting the market to provide access to affordable credit does not mean compromising standards. Firms need to comply with our regulatory standards, treat consumers fairly and provide good consumer outcomes. Our data shows that the high-cost market has reduced significantly since 2019, down by almost £3bn of lending, with more than 250 firms exiting the market. This was driven in part by historic unaffordable lending practices and redress liabilities resulting in a number of firm failures, unsustainable business models, and reduced availability of funding.

We continue to work closely with stakeholders including Government, trade bodies and Fair4All Finance to jointly seek solutions to help reduce the number of consumers unfairly excluded from affordable credit. We will use our convening powers to support access to affordable credit where needed, and continue to encourage innovation via the Regulatory Sandbox, Innovation Pathways and TechSprints, and support firms at the Authorisations gateway.

We encourage you to think about what you can do to innovate and provide greater access to affordable credit. This could include collaborating with government initiatives such as the No Interest Loan Scheme (NILS), offering transparent and competitive interest rates, providing financial education and tools to borrowers, implementing flexible repayment options, and leveraging technology to improve consumer journeys, streamline processes and reduce costs.

Reducing and preventing serious harm

2. Firms must lend responsibly and sustainably

Many consumers who borrow will display characteristics of vulnerability, low financial resilience, and have 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. Our Financial Lives Survey 2022 identified that 12.9 million adults have low financial resilience and 27.3 million adults showed at least one characteristic of vulnerability. Because of continued cost of living pressures, consumer vulnerability is increasing and financial resilience decreasing. We anticipate more consumers in the mainstream credit market will be facing these challenges for the first time, and others may seek to access alternative forms of lending, including higher cost credit.

It is more important than ever to ensure your firm makes sound affordability and credit-worthiness assessments. We have taken supervisory action where firms did not have adequate creditworthiness assessments in place. We have also acted where firms are driving poor consumer outcomes by relying on re-lending to sustain their business models and providing products that are designed to promote persistent use of credit, resulting in unsustainable borrowing and financial hardship. We expect firms to agree to refinance only where they reasonably believe that it is not contrary to the consumer's best interests to do so (CONC 6.7.18R).

Whilst we have seen some improvements, we remain concerned about sludge practices - harmful practices that create unreasonable barriers for consumers. Sludge practices can hinder transparency, put barriers in the way of consumers getting the support they need and heighten the risk of consumers disengaging with their lender. In some circumstances, friction in the consumer journey can support good outcomes, providing valuable safeguards such as additional checks to avoid fraud. We expect firms to apply judgement and be able to distinguish between positive frictions or nudges that support good outcomes and harmful frictions that create unreasonable barriers.

More firms are using artificial intelligence and open banking for lending decisions, and we expect to see a further increase in the use of innovative technology as it evolves. Firms need to test the effectiveness of these models, including benefits and risks, and ensure responsible lending practices remain at the forefront of any drives for improved consumer journeys and efficiency savings.

You have an obligation to ensure lending and re-lending is done affordably, responsibly and is sustainable over time to support good consumer outcomes. We expect you to act in good faith, prevent foreseeable harm, and support consumers with their financial objectives, as outlined under the Consumer Duty cross-cutting rules. We will continue to intervene where firms are not meeting these standards.

3. Firms must ensure that the price paid for a product or service is reasonable compared to the overall benefits

Price and fair value is a key outcome of the Consumer Duty. We expect firms in all Consumer Lending portfolios to demonstrate how their products and services offer fair value to consumers.

We understand that the credit risk of lending to certain cohorts of consumers is greater, and this may be reflected in higher product prices. However, we would not expect firms to capitalise by increasing prices unfairly and offering products that do not provide fair value.

We have carried out workshops with trade bodies across the portfolios to unpack how firms are applying price and fair value to their business models and have shared examples of best practice. Firms will need to make their own assessment of their products and services in line with section 7 of the Consumer Duty guidance. When firms perform value assessments, they may consider a range of factors to demonstrate that the price paid is reasonable compared to the benefits received, for example: costs to the firm, market rates and charges for comparable products.

Given rising interest rates in both the UK credit card and personal loan markets, this is a key focus for us. Firms must be able to demonstrate that the price the consumer pays for a product or service, and ongoing fees and charges over the product lifetime, are reasonable compared to the overall benefits the consumer receives.

Firms offering higher interest loans which are not subject to the high-cost short-term price cap is a particular area of interest for us, and firms must be able to demonstrate how the product offers fair value. In markets where a price cap does apply, we still expect firms to be challenging themselves around price and fair value. For example, a price cap shouldn't be seen as a maximum rate, and firms are still expected under the Duty to assess the value of their products, which could potentially lead to rates that are lower than the cap. We expect all firms to regularly review their pricing and fees and we will continue to test how firms are meeting this outcome.

4. Firms must support consumers in financial difficulty

Cost of living pressures mean that many borrowers will be experiencing higher costs and therefore more consumers may need tailored support to manage their debts.

During our multi-firm work on Borrowers in Financial Difficulty, we saw that many firms were not considering or taking sufficient account of consumers' individual needs or circumstances or providing appropriate tailored forbearance. We also identified that improvements could be made to better signpost consumers to debt support services. We published details in our November 2022 Key Findings Report which led to numerous interventions across the Consumer Lending market, both to prevent future harm and remediate where harm had already materialised. Our work has also secured up to £54.4m of redress for over 228k consumers across the consumer credit market, as of December 2023. We encourage firms to review the report and ensure they are providing effective consumer support for borrowers in financial difficulty.

Even where your firm is under financial pressure, you must ensure your operations and processes give consumers the support and service they need. For example, firms should ensure that: staff are adequately trained to manage calls, there are appropriate forbearance options to support consumer needs and communications are clear. Firms should also consider the Tailored Support Guidance (TSG) when supporting consumers in financial difficulty. We propose to move these existing protections into our Handbook which can be found under the *'Policy changes'* section of this letter. With inflation and cost of living pressures remaining high, we will continue to closely monitor how firms are supporting their consumers.

5. Firms must handle complaints and redress requirements effectively

Where firms manage their complaints poorly and do not identify learnings, we have seen in the high-cost market, this has led to large redress bills and some firm failings. More positively, we have also seen some firms embrace changes to improve their complaints handling processes, provide appropriate remediation to consumers and put in place practices going forward to operate compliantly and profitably, with improved Financial Ombudsman Service uphold rates as a result.

Whilst we have seen examples of improvements in this area, we remain concerned, and we expect to see more widespread improvements in how firms handle complaints. We expect you to regularly monitor outcomes and where systemic issues are identified, to notify us. We expect you to take reasonable steps to resolve the matter and consider whether remedial action is necessary, such as undertaking a review of historic lending and change firm practices dependent on the root cause of the complaints.

We are currently progressing a complaints multi-firm review involving a small number of high-cost lenders. Preliminary findings have identified areas where improvements can still be made, and processes strengthened. We will share our findings with the firms involved in due course.

The Consumer Duty consumer support outcome (chapter 9), sets overarching guidance in relation to the support firms should provide their consumers. You should read this in conjunction with other rules that cover specific elements of servicing consumers, such as our Dispute resolution: Complaints (DISP) rules.

6. Firms must have appropriate systems and controls in place to mitigate risks of Financial Crime

In current market conditions, illegal money lending and domestic financial abuse are likely to be growing risks in this market.

Illegal Money Lending

Our Financial Lives Survey (FLS) 2022 data shows that 0.5% (0.2m) of all UK adults had borrowed from an unlicensed money lender or another informal lender (i.e., an illegal money lender) in the 12 months up to May 2022, and this is a growing issue.

We want firms across the Consumer Lending market to be better at spotting signs of financial crime, so interventions can happen earlier to prevent foreseeable harm. If a consumer indicates they have loans from someone they know (such as friends or family) we encourage firms to probe this sensitively and appropriately and consider referring to the UK Illegal Money Lending Teams (IMLTs).

The IMLTs offer free, bespoke training materials, and support, for firms likely to encounter instances of illegal money lending. The training helps firms' staff understand how loan sharks operate, who is at risk of being exploited, and where victims can go for help. We encourage you to explore this.

We are committed to working with industry and IMLTs to help tackle illegal money lending.

Domestic Financial Abuse

We have been looking into how domestic financial abuse manifests in the use of financial services products, particularly noting heightened risks because of cost of living pressures. We want victim-survivors of financial abuse to receive fair and consistent treatment from firms, so that they can start rebuilding their financial wellbeing.

Consumers who have been coerced into taking out unsecured loans, including credit cards and personal loans, by an abusive partner may feel they have limited choice about entering into such an agreement at the point of borrowing, or the loan may be taken out in their name without their knowledge or consent. We encourage firms to be alert to the possibility of coercion to reduce foreseeable harm, and when a report is made, to treat the victim-survivor appropriately, so they do not experience further avoidable harm. This may include how firms treat repayment of any debts and how they are recorded.

We will continue to work with HM Treasury and industry to understand how firms are identifying and managing harm in this area. We encourage firms to consider how you can support victim-survivors and whether you need to do more to educate your staff and/or update processes.

7. Firms must have robust governance practices, ensuring effective oversight and risk management

Firms must have robust governance practices guaranteeing effective oversight and rigorous risk management protocols to identify, monitor and manage operational risks. Firms' culture and governance should drive good behaviours and produce fair outcomes that benefit consumers and markets. We have identified poor governance and inadequate senior manager oversight as a root cause behind several of the drivers of harm.

Through our regular firm engagement, including on-site visits to firms, we have observed instances of deficient oversight, ineffective governance structures, and vulnerabilities in systems and controls. In some cases, this has led to firm failures. These issues are prevalent across the Consumer Lending market but are particularly acute in parts of the credit union and high-cost portfolios.

Firms are reminded of their responsibilities under the Senior Managers and Certification Regime (SM&CR). The SM&CR aims to reduce harm to consumers and strengthen market integrity by creating a system that enables firms and regulators to hold senior individuals to account. For example, under the Consumer Duty we will be holding firms – including their senior managers and boards – accountable for delivering good outcomes for consumers. We have set an expectation that firms appoint a Consumer Duty champion at board (or equivalent governing body) level, to ensure the Duty is being discussed regularly, outcomes are tested and challenged appropriately, and that there is ongoing monitoring on how your firm is delivering the Duty. We expect to see senior leaders in firms driving the changes needed to meet the Duty standards.

Given market conditions, we are aware that there is an additional strain for some firms to attract and retain new Board members and Directors. For credit unions in particular, we have seen this result in further rationalisation and an increase in Transfers of Engagement. Boards should proactively plan ahead, including succession planning, as this supports effective governance which is fundamental to the viability of the business and delivering good consumer outcomes.

We have also seen recent examples where firms have failed to implement effective monitoring and oversight of third-party providers, resulting in the risk of consumer harm not being effectively mitigated. Our Operational Resilience Policy (PS21/3) came into force on 31 March 2022. Whilst the rules may not be applicable to all firms, we encourage firms to refer to the guidance and key learnings, to avoid operational disruption and to ensure third-party relationships are managed closely and effectively.

As part of firms' governance and oversight, strong cyber resilience is a top priority for us, the Bank of England, and the Prudential Regulation Authority. Disruption from cyber-attacks can impact financial stability, potentially causing foreseeable harm to consumers, other market participants and market confidence. Firms should read the CBEST thematic and embed the findings into their cyber strategies.

We want Boards and senior management in firms to create a healthy firm culture, with consumer outcomes at the heart of their business. In doing so, firms should have proper regard to Environmental, Social and Governance (ESG) strategy, improving diversity and inclusion (D&I), and making sure there is no place for non-financial misconduct. Our D&I consultation paper proposes new rules and guidance to help ensure firms can take decisive and appropriate action against discrimination, bullying and sexual harassment.

Setting and testing higher standards

The Consumer Duty

The Consumer Duty came into force for open products on 31 July 2023. We expect you to have implemented and embedded the Duty for open products and services and be preparing to apply the Duty to your closed books. We have seen many firms make positive changes to align with the Duty, for example, where vulnerable consumers are handled by dedicated, trained staff, and where firms have made changes to their website marketing to improve the consumer journey. However, we also continue to see examples where firms need to do more.

The Consumer Duty is not a once and done exercise; it's an ongoing commitment to good consumer outcomes. You should be monitoring data and other sources of information to ensure your firm is delivering good consumer outcomes across different consumer groups. We will continue to engage and support firms on what is required, alongside assessing how effectively you have embedded the Duty. Where we discover poor behaviours and a lack of regard for the Consumer Duty, we will prioritise the most serious breaches and act swiftly and assertively. In these instances, you can expect us to take robust action, such as interventions or disciplinary sanctions.

Under the Duty, you are required to carry out an annual assessment of whether your firm is delivering good outcomes for consumers and report this to your Board or Governing Body. We may ask to see your firm's Board report. Ongoing and effective outcomes monitoring is an essential input for the Board report and firms should ensure there is a clear audit trail of key decisions relating to the Duty. You will need to evidence the outcomes you are delivering for consumers, including groups of consumers such as those in vulnerable circumstances, and the actions you are taking to address any deficiencies.

From 31 July 2024, the Duty comes into effect for closed products and services. A closed product or service is one where (i) there are existing customers who took out contracts before 31 July 2023 and (ii) it has not been marketed or distributed to new customers, or open for renewal by existing customers, on or after 31 July 2023. Firms are expected to review their closed products and services against the higher standards of the Duty. As these products are not on sale, you do not need to identify a target market or develop a distribution strategy. You are however required to ensure you meet the requirements of the Duty, outcomes, and cross cutting rules.

There will be further communications around our expectations on closed books in the run up to implementation. Existing guidance can already be found under chapter 3 of FG22/5. We expect you to be considering what this means for your firm now.

Policy changes

In July 2023, the Government confirmed its intention to reform the Consumer Credit Act 1974 to ensure it is fit for purpose. It is likely to involve moving many provisions from the Act into the FCA Handbook. We are keen to ensure consumer credit regulation supports a well-functioning and competitive market, whilst maintaining the appropriate degree of consumer protection. We expect the Government to consult on more detailed policy proposals this year. We will work closely with the Government and industry on this.

In May 2023, we published our consultation paper (CP23/13), on strengthening protections for consumers in financial difficulty, moving aspects of the Tailored Support Guidance (TSG) for Consumer Credit and Mortgages into our Handbook on a permanent basis. We also proposed targeted additional changes to support consumers in financial difficulty. These proposals reinforce our expectation that firms put consumers' needs first and support firms acting to deliver good outcomes required under our Consumer Duty. We propose to bring the rules into force in 2024 and to withdraw the TSG at the same time.

We will also begin a review of our price cap for high-cost short-term credit (HCSTC). This will be the first review of our HCSTC rules since 2017, where we found that the cap, introduced in 2015, had resulted in cheaper loans, better affordability assessments, and fewer consumers experiencing debt problems.

In Autumn 2023 we consulted on the proposed introduction of Product Sales Data returns for consumer credit agreements. These returns would provide agreement level data on all consumer credit agreements and enable us to take a data led approach to the way we supervise the consumer credit sector enabling us to better prioritise our work and be more targeted with our interventions, reducing harm to consumers. We expect to publish a policy statement on these returns shortly and are working through the feedback we have received before we finalise our rules. Further communications to firms in scope of this return will be issued over the course of the implementation period.

Specifically for credit unions, the Financial Services and Markets Act 2023 was granted Royal Assent and came into force on 29 August 2023. As a result of these changes, credit unions in Great Britain can now apply to offer their consumers hire purchase agreements, conditional sale agreements, and insurance distribution services. In December 2023, we published our quarterly consultation (CP23/25) on consequential amendments to the Credit Unions sourcebook (CREDS) to clarify when and how our rules would apply to credit unions who elect to offer these newly permitted products. Our proposals, which are expected to come into force in Spring 2024, support financial inclusion and access to affordable credit while ensuring consumers are sufficiently protected.

Offering new products can potentially present risks to consumers, as well as benefits. Clear responsibility for new products, and accountability through the Senior Manager Regime, is a priority to ensure good outcomes for, and fair treatment of, consumers. Where firms are looking to introduce new products, please see here to assess what action you may need to take. We expect firms to have given due consideration to the risks associated with the product, have a strong understanding and knowledge and be able to demonstrate and explain how you will meet your regulatory obligations as part of any application.

Action for firms

You are responsible for ensuring that your firm meets our requirements, including the obligations and expectations set out above. A significant part of our supervisory activity over the next two years will be to test firms against our expectations.

We will continue to use data to identify outliers and measure market outcomes. We expect firms to co-operate with our data requests by providing accurate and timely data submissions which provide vital information to support our regulatory oversight of the Consumer Lending market. We do note that these requests can be time-consuming for firms, and we will continue to look to ensure any requests sent out are proportionate.

We also continue to see examples of the Financial Services Register not being kept up to date, which can hinder consumers being able to contact appropriate people in a timely manner. Firms should consistently update and maintain this information.

You are not required to respond to this letter; however, you should consider how it applies to your business and act as necessary, including discussing this letter with fellow Directors and/or Board members and agreeing actions. You should be able to explain what you did in response to this letter if asked by an FCA supervisor.

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 Martha Stokes, Consumer Lending Head of Department, on 0207 066 0894 or Martha.Stokes@fca.org.uk.

We look forward to working with you all to continue to improve standards, access, and consumer outcomes.

Yours sincerely,

Roma Pearson
Director, Consumer Finance
Supervision, Policy & Competition Division