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Our Ref: <ip number>

This message has also been sent by email to <email address>

Dear interim permission holder,

### **The FCA's expectations of high-cost short-term lenders**

As you may be aware your FCA application period for <firm name> ends on <application period end date>. If you do not submit an application before the deadline, your firm must stop carrying on consumer credit lending (including merely holding a loan book) or you will be operating illegally.

To assist you in understanding the FCA's requirements, I am writing to you today to summarise a number of concerns the FCA has uncovered in the course of supervising high-cost short-term credit (HCSTC) firms since April 2014. Given the importance of these concerns, we expect you to share this letter with your Board or equivalent as we will pay attention to these matters when assessing your application for authorisation. This letter highlights some key areas of concern but it is not a comprehensive list of all issues that have come to light in the course of our supervision activities. We may raise further issues, not referred to in this letter, with you during the authorisations process as we consider your specific application. We also provide some important information on the consequences of lapse of interim permissions and on the purchase of loan portfolios.

### **Credit broking including lead generation – your responsibilities**

In December we announced a series of measures specifically aimed at tackling poor practice in the credit broking market (<http://www.fca.org.uk/news/ps14-18-credit-broking-and-fees>). Although the measures primarily affect fee charging credit brokers, we are concerned about more than the transparency of broking fees. We have seen evidence of unacceptable consumer outcomes throughout the market, driven by lead generators and other brokers that fail to act in consumers' interests.

We remind you of your responsibilities in this regard. We expect you to take reasonable steps to ensure that any potential customer presented to you by a credit broker has been sourced in an appropriate manner. You should not pass on or sell customer data to any third party unless it is appropriate to do so. For example, passing accurate information on the status of a customer's debt to a credit reference agency in accordance with the terms of your contract.

We expect you to consider and act upon the implications of the measures that we have announced, particularly with respect to your relationships with credit brokers, but also in relation to how you acquire customers and use customer data more generally.

### **Ensuring that all loans to customers are affordable**

We have worked with a number of HCSTC firms to consider whether the loans they make to their customers are affordable. We are concerned that high levels of re-lending (where customers take a new loan shortly after repayment of an existing loan) or high levels of arrears and default may indicate that a firm is failing to undertake adequate affordability assessments at the outset. In addition, we have noted that some firms fail to conduct adequate checks to establish whether an individual customer can meet loan repayments in a sustainable manner, instead only conducting checks which are effectively limited to considering the risk to the firm of non-payment rather than the risk to the customer of over-indebtedness or having undue difficulties in making payments.

Firms will need to demonstrate in their applications for authorisation that they have proper processes in place, with appropriate governance and controls including monitoring and reporting arrangements, to make suitable lending decisions.

### **Fair treatment of customers in financial difficulties**

We have identified concerns about the way HCSTC firms are treating customers in financial difficulties. Below, we have set out three concerns which we expect all HCSTC firms to take account of.

First, firms should treat all customers in default or arrears difficulties with forbearance and due consideration. A common theme in firms we have looked at is that those in default or arrears difficulties are not being identified at an early enough stage (or at all in some cases). This included agents frequently starting conversations with customers in arrears by pushing for repayment rather than looking to explore forbearance options. It may be necessary to consider customers' financial circumstances when considering the appropriateness of certain forbearance options. Firms should have clear policies for the fair and appropriate treatment of customers who the firm understands or reasonably suspects to be particularly vulnerable. Firms should also direct customers in default or arrears difficulties to sources of free and independent debt advice where appropriate (this could be via written communications and telephone contact with customers, for example).

Second, firms should not unfairly limit or constrain customers' access to appropriate forms of forbearance. We have seen firms limiting access to some forbearance options based on the customer's circumstances at the time they took out the loan rather than on the customer's current financial circumstances. We do not think this is consistent with treating customers fairly. In considering if a customer is in default or arrears difficulties, the firm must treat

customers fairly under Principle 6 of the Principles for Businesses

(<http://fshandbook.info/FS/html/FCA/PRIN/2/1>), for example, in considering what evidence of difficulties it is reasonable to expect a customer to provide.

Third, firms must ensure that all communications with customers, through all channels, are clear, fair and not misleading. We have seen correspondence from firms to customers in arrears which implied that their account would be subject to legal or other action, including escalation to a third party debt collector, when this was not the case. We have also seen firms providing customers with misleading information about the consequences of their actions for their credit file.

### **Governance and controls to monitor compliance with policies and procedures**

We recognise that the HCSTC market has been subject to a lot of regulatory and public scrutiny and we have seen some firms making significant improvements to the way they are run. However, while we welcome the improvements that firms' senior management have committed to make, we have frequently found weaknesses in firms' control environments preventing changes from being effectively embedded. A firm must establish and maintain adequate policies and procedures as are appropriate to its business; these include effective systems and controls for compliance with applicable requirements and standards under the regulatory system, such as the requirement to treat customers fairly. We have seen examples of firms' IT systems which failed to prevent duplicate payments being taken or interest being calculated inaccurately, resulting in consumer detriment. Firms should take reasonable steps to ensure the systems of third parties who they outsource activities to support the fair treatment of customers. We also expect firms to be adequately resourced and to employ staff with the requisite level of skills, knowledge and expertise. And we expect firms to have the necessary risk management framework, including appropriate levels of monitoring and senior management oversight.

### **Implications of lapse of interim permissions**

We would remind you once again of the implications of missing the deadline for submitting your application for authorisation. If you do not submit an application before the deadline **<application period end date>**, your firm must stop carrying on consumer credit lending or you will be operating illegally. This includes the act of holding a loan book (having the right to exercise the lender's rights and duties under a regulated credit agreement), even if you are not proactively engaging in relevant activity. A firm without an appropriate interim permission is not only prohibited from granting any further loans, it also cannot continue to have the right to any further payments from customers in respect of loans it has already granted - even where the relevant loans were made prior to the expiry of its interim permission. Placing your loan book with a debt administration or collection firm (to exercise or enforce your rights and duties on your firm's behalf) or another FCA authorised firm (for example a law firm) to collect monies owed to you, would not avoid you conducting unauthorised regulated lending. Any regulated credit agreements for which you are the lender will be unenforceable as long as you do not hold the relevant permissions.

If your firm unlawfully carries on a regulated activity (such as holding rights and duties under a regulated credit agreement) once its interim permission has ceased, it will need to consider its position in relation to the offences in Part 7 of the Proceeds of Crime Act 2002 (money

laundering). For example, it should consider whether it should prevent payments being made to it under regulated credit agreements.

We would also remind you that under Principle 11 of the Principles for Businesses (<http://fshandbook.info/FS/html/FCA/PRIN/2/1>), we expect you to notify the FCA should you intend to cease regulated activity or make a significant change to the nature of your business. Likewise, if you have plans to expand your business, for example, through the purchase of an existing portfolio of loans, you are obliged to notify us in advance. We expect notice to be given to us at an early stage, before making any internal or external commitments. You can do so by contacting the Contact Centre on 0300 500 0597 or [firm.queries@fca.org.uk](mailto:firm.queries@fca.org.uk).

### **Responsibilities of firms purchasing existing loan portfolios**

We expect any firm contemplating purchase of an existing portfolio to conduct robust due diligence, including on the compliance of the agreements with the Consumer Credit Act 1974, the Unfair Terms in Consumer Contracts Regulations 1999 etc. The consequences, for example, of improper execution of a regulated credit agreement or of the legal unfairness of a contract term for the enforceability of the agreement or the term apply as much to a purchaser as to a seller and will significantly affect how a purchaser is expected to treat the borrowers under those agreements. In addition, the FCA may exercise its power to impose requirements on a prospective purchaser of a loan book to take specific action to ensure that consumers are treated fairly. We bring your attention to the requirement in CONC 7 (<http://fshandbook.info/FS/html/FCA/CONC/7>) to treat customers in default or in arrears difficulties (including customers under portfolios of loan agreements purchased from another lender) with forbearance and due consideration that would include, depending on the circumstances, considering suspending, reducing, waiving or cancelling any further interest or charges.

### **Finalising your application for authorisation**

You may wish to consider the points we raise in this letter, and how you can demonstrate that you meet the required standard, in your application for authorisation. If you have already submitted your application you may provide your case officer with additional supporting information should you consider this necessary.

Yours faithfully,

Tracey McDermott

Director, Supervision and Authorisations