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finance

Introduction to the Good Practice Lending Guide

July 2024

What are we covering today?

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About Fair4All Finance

Background and purpose of the Guide

Introduction to the modules

How to use the Guide

More detail into two modules

What else is coming?

About Fair4All Finance

We are a not for profit organisation driving changing in financial services to help the millions of people in vulnerable circumstances.

Invest in organisations already serving those in vulnerable circumstances well

Catalyse investment in developing new products and services

Research to generate a rich evidence base to inform policy and regulation

Purpose of the Guide

To support lenders with the credit risk management aspects of running a consumer credit business effectively

Including:

1. Credit risk activities that cover the customer journey
2. Governance and regulatory compliance
3. Management information

Audience, approach and scope

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Audience

- For the community finance sector
- Focus is on smaller, not for profit firms

Approach

- A free accessible resource
- Provides in-depth explanations, practical examples, advice and guidance that aligns to UK regulations

Scope

- Covers areas organisations must address when running a successful credit granting business
- Fifteen modules covering different risk management topics, from credit risk appetite, to arrears management to calculation of provision

Introduction to the modules

Overview of the modules

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Introduction

1. Risk Appetite	2. Proposition Design	3. Application Process	4. Lending Policy (Credit risk)	5. Lending Policy (Affordability)
6. Customer Verification and Fraud Prevention	7. Consumer Duty and Complaints Handling	8. Credit Reference Agencies	9. Scorecard Monitoring and Model Risk Management	10. Portfolio MI
11. Arrears and Collections Strategy	12. Data Maintenance and Retention	13. Governance	14. Provisions and Write-off	15. Debt Advice and Financial Literacy

How to use the Guide

Each module is standalone and can be used independently of the others.

The Guide can be used as:

A reference manual, to help you enhance your lending practices	An assurance tool, to assess if any gaps or shortcomings exist in how your organisation assesses risk and makes lending decisions	To support new organisations in setting up the appropriate credit risk management practices that they need to succeed	A learning/reference resource for new or existing staff

The Guide can be accessed directly from the Fair4All Finance website here:
https://fair4allfinance.org.uk/resources/good-practice-lending-guide

RM05 – lending policy affordability

RM05 – lending policy affordability

This module includes:

- Regulatory guidance on assessing affordability

- Data sources available for income and expenditure calculations

- Calculating affordability for sole and joint applications

- The application of affordability buffers and stress testing

- Several worked examples, covering different scenarios

RM05 – lending policy affordability

We have selected some areas of interest to talk about in a bit more depth from the chapters within the lending policy affordability module.

- **Introduction/scope**
  - What is affordability and why is it important?

- **How affordability can be calculated and verified through use of customer supplied data and third-party services**
  - Calculating a customer's monthly income and expenditure

- **Buffers and tolerances**
  - Calculating head room to ensure that customers have some disposable income remaining

- **Regulatory guidance on affordability assessments and learning from industry experience**
  - FOS cases relating to affordability – common themes and findings

What is affordability and why is important?

When evaluating creditworthiness, an assessment of the customer's ability to make their repayments; i.e. the affordability of the loan. The key elements of affordability are:

Income (£): This is a customer's net income. As well as income from paid employment, it can include benefits and any other income they have

Expenditure (£). This covers outgoings. This covers non-discretionary spending such as housing costs and utility bills, as well as discretionary spending on things such as clothing and leisure activities

Base affordability (£) = Income – Expenditure + *Stress Factor*

Lenders are required to consider probable changes (both positive and negative) to the customer's finances over the duration of their credit agreement. One way to represented this is as a *Stress Factor*.

# Calculating monthly income and expenditure

Type of income	Verified amount (£)
Net Monthly Income (Base Salary Payslip)	1,500
Net Monthly Income (Secondary Job Payslip)	380
Regular Benefits	0
Other Income (e.g. from savings and investment)	100
Total	**£1,980**

Type of payment	Verified amount (£)
Non-Discretionary Monthly Credit Commitments	
Credit Card Payments	100
Loan Payment	420
Non-Discretionary Monthly Contractual Repayments	
Utility Payments	110
Council Tax	150
Rent	450
Non-Discretionary Monthly Other Payments	
Food	100
Monthly Discretionary Expenditure	
Restaurants and Hotels	100
Recreation and Clothing	20
Total	**£1,450**

Each item of income and expenditure must be verified. This can be done using resources such as open banking, customer supplied documents, credit reference agencies or Office of National Statistics (ONS) data.

Tolerances and buffers
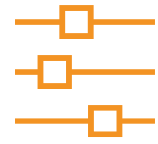
Tolerances: You can't assume that what the customer says is always accurate. For example, someone's stated mortgage repayments or spend on leisure activities

Credit Reference Agencies and the ONS can provide *estimated* values, but these may be imprecise. Tolerances are required to identify when a discrepancy is likely

Buffers: An affordability calculation may indicate a loan is technically affordable yet leave the customer with very little disposable income

A buffer is included in affordability calculations to cater for any unexpected or additional expenditure that customers may incur

Buffers and tolerances can be set in several ways. For example, as a fixed amount, as a percentage or a mixture of the two

FOS cases relating to affordability – common themes and findings

To CONC or not to CONC?
- Credit unions must follow the FCA's Credit Unions Sourcebook (CREDS)
- However, following Consumer Credit Sourcebook (CONC) principles demonstrates good practice and reduces the risk of FOS complaints

Income is not enough
- A high income does not mean that someone can afford a loan
- There are upheld FOS cases where full affordability was not assessed due to the customer's "high" income

Each loan is different
- Being able to afford an initial loan does not mean that someone can afford subsequent loans
- A new affordability assessment each time additional lending is considered

RM07 – Consumer Duty

RM07 – Consumer Duty

This module includes:

- The core principles and target outcomes of consumer duty

- Dealing with vulnerable customers

- Complaints handing

- Monitoring compliance with consumer duty

- Many practical examples of what "good" and "poor" practice looks like

RM07 – Consumer Duty

We have selected some areas of interest to talk about in a bit more depth from the chapters within the Consumer Duty Module.

- **Introduction/scope**

  - What are the four outcomes?

- **The four outcomes**

  - Learning by example:

    - Price and Value Outcome

    - Customer Service Outcome

- **The management and governance of Consumer Duty**

  - Assessing a firm's performance against Consumer Duty

What are the four outcomes?

Price and Value
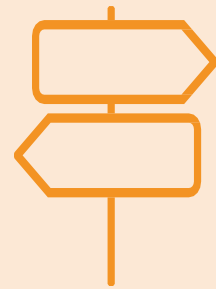
Products and Services

Customer Support

Consumer Understanding

As part of achieving these outcomes, lenders must monitor, evidence and regularly review the outcomes that their customers are experiencing in practice and take action to address any risks to good customer outcomes.

Examples of good and bad practice

A lender has designed and developed three new products to take to market.

Outcome	Price and Value Outcome
Good Practice	A focus group was set up at the start of the design phase to understand the needs of the target markets for each of the products This focus group included the consideration of customers in vulnerable circumstances, to derive an inclusive product
Poor Practice	The target market was not clearly identified and there was no further research carried out to understand the needs of customers in vulnerable circumstances

Examples of good and bad practice

A lender has produced a product with misleading advertisements and has just realised their mistake.

Outcome	Products and Services Outcome
Good Practice	The lender stops all misleading advertisements for the product to prevent further harm to customers. They issue a corrective statement, which is clear, transparent and jargon free, to ensure that it is easy for anybody to understand. This statement admits the mistake and takes full responsibility. The lender apologises and provides options to the customers affected. These options include a fee free switch to a more suitable product or an exit from the product without a fee. The lender compensates customers for any losses, financial or otherwise, they have incurred. The lender reviews their marketing and advertisement processes to understand how a similar issue can be prevented in the future. For instance, employee training or more rigorous internal checks.
Poor Practice	The lender notices the mistake and immediately fixes the misleading advertisement. The lender does not reach out to the customers that are affected, but instead, hopes that nobody will notice. They will deal with any complaints as and when customers raise them. This is not good practice. The lender has not owned up to their mistake and customers have suffered. This can lead to customer complaints, causing financial and reputational damage to the lender.

Assessing performance against Consumer Duty

Firms should regularly monitor how they are delivering against the four Consumer Duty outcomes, and address any weaknesses identified. The following is an example of the areas a firm could monitor against the Consumer Support outcome:

Customer support monitoring area	In more detail
Call monitoring	Recording and reviewing calls to ensure they align to procedures and compliance requirements
Written communication monitoring	Reviewing written communications to ensure they align to procedures and compliance requirements
Call times	Assessing if call waiting times are within agreed service levels
Customer feedback	Assessing how customers feel about the service they receive using different feedback channels such as focus groups, surveys, rating websites
Early withdrawal from products	Ascertaining how many customers withdraw early from products and the reasons why
Forbearance measures	Assessing the outcome of forbearance measures undertaken when customers were struggling to make their repayments or alerted the lender to changes in their circumstances
Outages	Analysis of any app, website or IT outages that impacted customers

Firms should adopt a proportional approach based on the range and complexity of the products they offer, that is realistically achievable with the resources available to them.

What else is coming?

Further support

Module deep dives

Webinars to deep-dive into different modules of the Guide

Workshops

Smaller group sessions to address topics specific to your organisation

Please drop into the chat any requests for modules/topic areas to cover in the deep-dives or workshops.

The Guide can be accessed directly from the Fair4All Finance website here:
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Any questions?

Thank you!

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