Good Practice Lending Guide

RM02 Proposition Design

May 2024

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1 Introduction

1.1 Why is proposition design important?

When designing a credit product to offer customers, the product, together with how customers are selected, targeted and managed form the wider product proposition. In creating a product proposition, the requirements of the both the customer and the business need to be considered:

- **Customer requirements.** This about how the lender identifies the target market, presents the product and interacts with the customer when they first encounter the product and then progress through the application process. This is to ensure that they receive a product that is appropriate for their needs, is priced appropriately, they receive good customer service and are provided with the information they need to be able to make an informed choice when deciding whether to accept a loan offer, should they receive one
- **Business requirements.** This is about designing a product that it is competitive in the marketplace and generates sufficient revenues to cover the costs of lending, while remaining within the firm's risk appetite. From a revenue perspective, this covers things like the amount, term and interest rate of the loans being offered plus any arrangement and other "one off" product fees that may be charged. From a cost perspective, this covers funding costs, operational costs of opening and managing accounts, plus bad debt charges from loans that are not repaid

Both these aspects of the proposition are equally important but for different reasons. A lender that fails to get the business requirements right risks making a loss and/or offering a product that no one wants because there are better (cheaper) alternatives on offer or overextending themselves by creating too much demand[1]. A lack of consideration of the customer requirements and how a product is presented to customers means that a lender is at risk of falling foul of their obligations under Consumer Duty[2], which could ultimately lead to enforcement action by the FCA if they feel that customers have not been fairly treated. In combination, a lender that doesn't offer a proposition that suits emerging customer needs in a compelling way, may lose its competitive position in the market, where other providers respond to that need and recognise the opportunity it presents. This is the core finding of the Fair4All Finance

[1] Which may impact their capital reserves and/or their liquidity
[2] The FCA's Consumer Duty principle, which is one of the 12 Principles of Business described in the FCA handbook that lenders must follow.

segmentation model – which identified approximately 17.5m people in vulnerable financial circumstances who are underserved or excluded. Some of these, need different propositions to better serve their needs and this presents opportunities for providers across financial services.

1.2 Why has Fair4All Finance commissioned this guide?

In our work with community finance lenders, those we have made significant investments into, and those we have funded through grants and capability support, we have come across a range of approaches to credit risk and provided consulting support to enhance them in many instances. This guide reflects our intention to document what good practice looks like when designing a new credit product and marketing it to consumers in a way that aligns with the FCAs Consumer Duty principle.

1.2.1 Purpose of this document

This document is intended to support Community Finance lenders in designing their credit products in a way that takes into account both the financial aspects of providing a credit product and the customer requirements to deliver products that are appropriate for them, that they understand and are priced appropriately, resulting in good customer outcomes. Together, we refer to this as the **product proposition**.

The approaches to proposition design described here are generally applicable to all UK lenders, but it is primarily intended for small to medium sized organisations who are working to provide fair and affordable credit to sectors of the community who may otherwise not have access to design approach guidance, others may want to validate the approach they've adopted. For example, not-for-profit community lenders and credit unions. Therefore, in this guide we adopt a proportionate approach suitable for these types of organisations.

Organisations can use the Guide in one of two ways:

1. As a reference manual, to help them enhance their own propositions for loan products and to provide assurance that there are no gaps or shortcomings. Although this guide is focussed on credit, some of the principles in it will be equally pertinent to the development of other propositions for customers.
2. To support new organisations in designing loan propositions for their target market

The focus of this document is proposition design. However, there are clear overlaps with other areas of the Good Practice Lending Guide, such as the loan application process, credit risk and affordability assessments. These are signposted within the relevant sections throughout this document.

2 Scope

In creating a product proposition, all aspects of credit management require consideration. However, given that the following elements of credit management:

- Risk appetite
- The application process
- Credit risk
- Affordability
- Consumer Duty
- Arrears and debt recovery

are covered in a separate section of the Guide, these elements won't be covered in this document in detail, but reference made to them where appropriate.

2.1 Legislation and regulatory guidance

In this section we discuss legislation that is relevant to the proposition design of loan products.

2.1.1 Consumer Credit (Advertisements) Regulations 2010

The regulations provide specific and detailed requirements about the information that must be provided in marketing literature. This includes a requirement to provide representative examples of a loan agreement terms, in any material that specify the product's cost of credit or APR.

Most Credit union lending is deemed to be unregulated, and therefore exempt from some aspects of the Consumer Credit Act. However the advertising regulations apply to all credit advertisement, both regulated and unregulated. These regulations also apply to CDFIs and other lenders.

The regulations are discussed in more detail in Section 3.

2.1.2 Advertising Standards Authority (ASA)

The advertising standards authority has its own set of standards for advertising that are independent of the consumer credit regulations and include financial services activities that are not regulated by the FCA. This means lenders can fully comply with the Consumer Credit (Advertisements) Regulations 2010 yet still all foul of the ASA.

In particular, as the ASA states, that adverts for high interest short term lending must be "socially responsible[3]." There have been several cases where the ASA has upheld complaints against lenders because they deemed that the lender's advertising encouraged "frivolous spending" or that credit was being promoted as a good way to fund one's social life – which it deemed not to be a socially responsible use of credit[4].

2.1.3 Credit Union Sourcebook

The credit union source book (CREDS) is managed by the FCA and details the product constraints that apply to credit union lending. In particular[5]:

- The maximum APR that can be charged is 3% per month (42.6% APR) for credit unions in Great Britain. For credit unions in Northern Ireland, the limit is 1% per month (12.7% APR)
- The maximum loan amount is limited to £15,000 above the member's shareholding. Practically, this means many credit unions specify a fixed maximum loan amount of £15,000 in their marketing and during the loan application process but may offer larger loans in specific cases where the member also has a significant shareholding. This limit is reduced to £7,500 if a credit union's capital to asset ratio is less than 5%[6]
- The sum of exposures of more than £7,500 must not exceed 300% of a credit unions capital, without the credit union pre-notifying the FCA[7]
- The maximum term for a loan is 5 years for an unsecured loan and 10 years for a secured loan

Credit unions can lend outside of these constraints, ie provide mortgages and/or products that are deemed to be regulated credit under the consumer credit act by applying to the FCA for separate regulatory permissions to carry out these activities.

2.1.4 PRA price cap (high-cost short term credit)

The FCA has placed limits on the maximum fees and charges that can be applied to loans and other forms of consumer lending[8]. These state that:

- The maximum daily equivalent APR cannot exceed 0.8% per day
- The total cost of credit for a loan cannot exceed 100% of the amount borrowed. This includes

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[3] "Socially responsible" can be interpreted as aligning with Consumer Duty. In which case this brings ASA and FCA into closer alignment on credit advertising. ie failing to be socially responsible is also a failure of Consumer Duty.
[4] https://www.asa.org.uk/advice-online/consumer-credit.html
[5] See CREDS section 10 for the full list of lending conditions
[6] CREDS 10.3
[7] CREDS 10.4
[8] https://www.fca.org.uk/firms/high-cost-credit-consumer-credit/high-cost-short-term-credit

interest and all fees and charges

- If a borrower defaults, the maximum default fee that can be charged is £15
- A lender cannot increase the interest rate on a loan when a borrower defaults

All consumer credit products must be designed within these constraints. Given the restrictions on APRs detailed in CREDS, it is unlikely that credit union lending will exceed the price cap. However, technically the PRA Price cap applies in addition to the rules in CREDS, credit unions are not exempt.

2.1.5 Consumer duty

The FCA's Consumer Duty Principle[9] means that products must provide good outcomes for customers. Specific requirements of the Consumer Duty relating to product proposition are discussed in Section 3.

Further details about Consumer Duty more widely are provided in the Consumer Duty and Complaints Handling component of the Guide.

2.1.6 Data protection

A potential customer must be notified (via a privacy notice) and their consent obtained, as to the purposes of any data that a lender holds about them. This includes information used for marketing and pre-application purposes.

If a lender is simply providing details about their products and services, such as a webpage with an affordability calculator for different loans, this will not require someone's consent unless the webpage includes software (cookies) that gathers personal information about the individual while using the website. It is only when the individual making an enquiry enters their details and data held by the lender becomes associated with the individual that data protection becomes relevant.

Further information about privacy statements is provided in Section 3.5 of this document. Data protection is also discussed in the Data Maintenance and Retention components of the Guide.

[9] PS22/9

3 Customer requirements

3.1 Determining the target market and their requirements

For credit unions, the target market will be a subset of their common bond whether that is defined geographically or by affinity group[10]. However, there will be customer segments within the common bond seeking different lending products. There will also be cases where people seek to become members of a credit union primarily because of the loan products being offered by the credit union.

For other types of lenders there may not be a concept of membership, but lenders often adopt different approaches depending on whether someone is a new or existing customer – which is somewhat analogous to membership status.

However, regardless of whether someone is a new or existing customer, there are two approaches to that can be adopted to identifying target customers.

1 Identify a customer segment with a specific need and seek to design a proposition that addresses those needs in a way that provides good value for those customers

2 Create a product, then decide who the target market for that product is

Option 1 represents best practice. Ideally, one should always start with the customer's requirements and then design a product proposition around that. However, sometimes a lender may already have a product that they want to relaunch or have certain operational constraints that restricts the types of products they can offer. In these cases a lender needs to undertake appropriate customer research to identify which customers their products are appropriate for. However, this is riskier as there may not be a clear target market, and the product may not meet the needs of sufficient numbers of customers to meet business objectives.

In either case, the proposition must be suitable for the customers it is targeted at in line with the FCA's Consumer Duty principle. A lender shouldn't assume that just because an existing product satisfies the Consumer Duty principle for its current customer base, that that automatically means it is also suitable

[10] Credit unions can only lend to members who have a shareholding with the credit union.

for new customers going forward. This is particularly the case if the product is being targeted at customers with different geo-demographic profiles or product needs.

To satisfy the Consumer Duty principle, the proposition design needs to consider the 4 Consumer Duty outcomes as detailed in Table 1.

Table 1. Outcomes supported by the Consumer Duty principle

Outcome	Detail	Considerations for proposition design
Price and value	Consumers receive fair prices and quality	Price is one factor, but value requires consideration of the relationship between the price charged to the customer and the benefits that they receive i.e. cost vs benefits (both financial and non-financial)
Products and services	Consumers are sold and receive suitable products and good service	The proposition needs to be designed to align with the needs, characteristics and objectives of customers in the product's target market
Consumer support	Consumers receive good customer service	Staff are trained to deal with customers with different capabilities, who are struggling or vulnerable, and provide them with, or direct them to, appropriate support services (ie not-for-profit debt advice services)
Consumer understanding	Consumers increase their confidence in financial services markets and can make better, more informed decision about the products and services they need	Marketing materials, documentation and all customer communication related to the product should be concise, easy to understand and does not mislead customers. Materials should be designed around the target market, taking into account the complexity of the product and the channel of communication used, whist considering customers with vulnerabilities

For the purpose of exploring the Consumer Duty outcomes in relation to proposition design, we'll use a case study based on the All Welcome Credit Union (AWCU) and their new product proposition.

AWCU has identified, via the use of open banking, that there is a sub-set of its membership whose income is erratic. When these customers have been granted loans previously, they are far more likely to miss odd payments (and hence incur late fees, and even where these are not part of a lenders' product configuration to incur greater in-life management costs to chase missed payments) than those with a steadier income. However, these customers tend to resume repayments, and overall, their repayment performance in terms of the volume of bad debt and write-offs is just as good as other customers who have a steady income.

AWCU has decided that it wants to create a new product that targets this group of erratic payers with loans of between £2,500 and £7,500 over terms of between 12 and 36 months. The product is unique in that it allows customers to "Buy" several interest free payment holidays over the term of the loan. Each time the customer uses a payment holiday they pay a small fee – maybe £10 or £20, but this has yet to be decided[11] and is discussed further below.

A customer can contact AWCU at any time, and as long as they are currently up to date with their repayments and not in serious financial difficulty, they can decide to miss their payment that month with an additional month added to the term of the loan for each month of the payment holiday. To do this, they need to contact AWCU and pay the holiday fee before the payment holiday can commence.

This is a new type of product that AWCU has not offered before. In the past, payment holidays where only offered as a forbearance measure when customers were in arrears.

The approach to each of the four outcomes is discussed in the following sections.

3.1.1 Price and value

In considering how to price the product and the value it provides customers, AWCU has undertaken an impact assessment that includes both the benefits and drawbacks of the product, as detailed in Table 2.

Table 2. Impact assessment for AWCU's payment holiday product

Price impacts	Value impacts
• In providing the flexibility of payment holidays there will be additional staffing costs to deal with payment holiday requests	• Customers won't worry as much about missing payments. Less stress / improved quality of life

[11] The fee is far less than a standard monthly repayment would be. Even for loans of £2500 offered interest free over 36 months, the monthly repayment would be £69.

Price impacts	Value impacts
• Cost of funds will increase due to longer repayment terms but no additional interest revenues	• Customers will benefit from a better credit record, if they make use of the payment holidays rather than entering arrears
• Customers will be less likely to incur late fees by making use of the payment holidays	• Loan terms will be longer if payment holidays are used. This won't directly increase the customers costs but means they will be indebted for longer
• Consideration needs to be given to the affordability of the holiday fees during the loan assessment process and when the payment holiday is applied for	• This is a more complex product than a standard loan. Therefore, some customers may struggle to understand it
	• There is a risk that financially vulnerable customers may use the payment holidays to mask more serious underlying financial difficulties

AWCU then hold a formal minuted workshop, with senior management stakeholders which includes representation from credit risk, customer relations, operations and finance. At the workshop, they discuss how the product should be priced, taking the pricing and value impacts recorded in Table 2 into account. During the workshop, the following points were discussed and noted.

- AWCU's standard loan products are loans with APRs of 12.9% for between £2,500 and £7,500. These products have recently been assessed by AWCU's auditors who concluded that the loans are priced appropriately and provide good value for customers. The finance director has confirmed that the business is making a reasonable return on these loans. Therefore, this has been taken as a baseline upon which to assess the pricing structure of the new product
- There are additional costs to consider. This includes higher cost of funds due to the extended term of the loans and the extra administrative overhead to manage the process, including the collection of the payment holiday fees
- The payment holiday fee should be less than the late fee charged when a customer enters arrears. It was agreed it would be unfair, and not be seen to act in good faith, to charge customers more for arranging a payment holiday than for allowing their account to become delinquent
- It was also agreed that the holiday fee must be significantly lower than the late fee if the product is to provide good value, and to meet Consumer Duty principles around fair pricing. It

could also harm AWCU's reputation if it was seen to be making a profit from payment holiday fees

- Market research suggests that this product is novel. There are no similar products currently being offered by UK credit unions (the £10 holiday fee element in particular)
- The customer receives a number of additional benefits over and above a standard loan. Specifically, greater flexibility and a mechanism to avoid paying late fees if they are struggling to meet their repayments. The fact that the product will support an improved credit record, via reduced arrears being reported to the CRAs, was also considered an important benefit
- The workshop agreed that the additional benefits represent additional value to the customer. Therefore, it would be reasonable for this to be reflected in the product pricing (APR)
- A number of variants on the holiday fee idea were discussed. For example, charging a fixed upfront fee up to cover the payment holidays, with a rebate given if the customer didn't use them. However, this was discounted on the basis it would be too confusing for customers to understand and might cause harm through customers expecting rebates they were not entitled too
- Concern was raised over the issue of potentially masking serious arrears problems with lots of payment holidays. It was agreed that this would be carried forward as a consideration for staff training and the approach to customer engagement

The workshop concluded that the new product was, in principle, fair and provides good value. Based on this conclusion, and supported by analysis presented by operations and finance, the terms of the product were finalised as follows:

- APR of 15.9% This represents a 3% premium compared to the 12.9% for standard loans. 2% of this increase was based on analysis undertaken by the operations and finance teams as to the additional costs of providing the product. The additional 1% was considered a fair premium, representing the benefits that the product provides over and above the other types of loan AWCU provides
- The fee for each holiday to be set at £10. This is based on the costs of administration of the holidays, but also taking into account the discussion around late fees and reputational risk.
- A maximum of 3 payment holidays to be taken during any 12-month period. This is somewhat arbitrary, but it was felt that it would not be a good outcome for customers to take too many holidays
- As per standard loans, the loans would be for between £2,500 and £7,500 over 12-36m.

3.1.2 Products and services

Having come to a view on the pricing and value elements of the new proposition, AWCU then move on to consider how to align the product with customers to ensure that customers are offered the product that is most appropriate for them.

To support this process, credit risk and finance have worked together to come up with a definition of an erratic customer, based on analysis of six months' worth of open banking data, combined with historic loan performance information. The definition they have arrived at is based on the regularity of income and the variance in income amounts, and how this correlates with customers who exhibit frequent mild delinquency. The analysis also showed that approximately 10% of their members could be defined as "erratic" customers, and this was a sufficiently large proportion to cost justify a product aimed at this group.

Both the standard and new loan products will be advertised on AWCU's website. Any customer can apply for any product. However, when a customer applies for a loan, they will be assessed to determine if they are an erratic payer or not and managed as detailed in Table 3.

Table 3. Approach to loan applications

Product applied for	Erratic Payer?	
	No	**Yes**
Standard loan	Follow existing loan process for standard loans	Discuss loan requirements with customer, with a view of directing them towards the new loan product
New loan (with payment holidays)	Discuss loan requirements with the customer, with a view of directing them towards a standard loan	Follow the revised process for the new loan product. This includes providing the customer with extra details about the payment holidays, what they cost and how to use them

The actions in Table 3 are important in ensuring that the customer is directed to the best product for them. In particular, it would not be a good customer outcome if a customer with a regular income ended up taking out a more expensive loan payment holiday loan, if they were unlikely to need to payment holiday facility.

Note that in this example, AWCU had the analytical resources to be able to proactively examine its customer base to produce a data-driven definition of "Erratic customer." Consumer Duty allows lenders to act proportionally given their size and resources. In line with this proportionality principle, if analytical resource were not available, then it would have been reasonable for AWCU to use another approach to defining erratic customers. For example, applying the expert opinion of the underwriting team or the head of credit to derive a definition based on their considerable experience of assessing customers' financial situations in the past.

3.1.3 Consumer support

In developing the new product, AWCU has identified some customer support requirements that differ from the standard loan product. In particular:

- **During the loan application**. Loan officers will need to be suitably trained to discuss how the payment holidays work if customers have questions. Some changes to the standard pre-application and application webpages will also be required
- **When a payment holiday is requested.** Customer services need to determine if the customer is experiencing financial difficulties in line with AWCU's pre-delinquency strategy[12]. If the customer meets the pre-delinquency criteria, then they need to extend the discussion to explore if a payment holiday is appropriate or if some other strategy would be better. It is noted that customer services will need to differentiate between a "blip" in income that is expected with erratic customers and a more structural long-term issue with the customer's finances

To facilitate this, the head of operations is tasked with the design and delivery of appropriate training for his team, and to liaise with IT over the changes required to the website.

3.1.4 Customer understanding (during the application process)

To support customer understanding of the product(s) on offer, customers need to be provided with appropriate information at each stage of the customer journey. Consideration therefore needs to be given as to what information needs to be provided and how that information is delivered. The customer needs to be fully informed at all times, from initial enquiry through to the completion of the loan (and even beyond that in some cases). It's important that this information is clear, easy to understand and not misleading. However, the biggest decision for customers, and the one that requires the most information, is the decision to take out a loan in the first place.

Table 4 details the approaches a lender can consider for informing the customer during the application process.

Table 4. Keeping customers informed

[12] See the arrears and collections component of the guide for more information about pre-delinquency.

Stage of the customer journey	Approaches to informing the customer
Pre-application (when the customer is exploring the products on offer).	• Simple description of what the product is and what benefits it provides. This will include the range of APRs, terms and amounts available (there will be legal requirements around this as well – see Section 3.4) • The fees and charges that apply. The APR provides a standardised view of the total cost of credit, but if this includes things like arrangement or final documentation fees, these should be clearly stated and explained (see also Section 3.4) • Eligibility questionnaire / self-assessment process. If the customer fails this, then provide explanations and pointers to places they could go for advice or support • Special features of the product are made clear. For example, early repayment options, payment holidays, cash back and so on. • Calculators to allow customers to work out how much their loan will cost on a monthly /weekly basis • Calculators to help customers calculate their affordability. • Sample credit agreements that allow customers to see all the terms and conditions before they apply • Routes to obtain additional information or ask questions about the product. This may be via an online chat service, an email address or a phone number they can call • Alternative channels / formats for receiving information. For example, if they are visually impaired, option to call someone to obtain the information they need
During application	• Presentation of a clear privacy (data protection) statement detailing how their information will be used • Supporting information around every question they are asked. This does not mean that reams of information are provide by default, but that there are routes to providing information if required, such as tool tips • Routes to obtain additional information or ask questions about

	the product.
At initial decision, pre-contract signing.	• Contract provided • Summary statement of the key terms and conditions. The summary does not replace the contract but is a "one pager" that summarises the key product terms within the contract. This should include the amount borrowed, APR, term, repayment schedule and any fees that may be charged (e.g. for late payment or early repayment) • Contact details if the customer has any outstanding questions before they sign the agreement
Following contract signing	• A copy of the contract and summary statement • Welcome letter/message. This should include contact details if the customer has any questions about their loan

An important practical consideration is the time and effort customers spend accessing the information they need as their application progresses.

The lender needs to provide all the information that the customer requires. They must also supply any information required to comply with the Consumer Credit Act and FCA regulations.

Proposition design to optimise the customer journey

If there are too many steps the customer has to go through, this could be both confusing and a dis-incentive to proceed further. Therefore, optimisation of the customer journey from pre-application to loan completion should be a consideration within the proposition design. Often, this may only require relatively minor adjustments to the customer journey compared to the lender's existing products. For example, if a new product just offers loans with slightly different APRs and loan amounts for the current offering, then the changes should be relatively minor.

If, however, the new product is significantly different, or is targeting a different type of customer, then the whole application process should be reviewed to ensure that it is fit for purpose, with new or modified processes developed if required.

Tools to support customer journey optimisation

There are a number of tools that can support this.

Web-analytics can analyse how customer for existing products use the lender's current website and this provides input to the design of the new proposition.

A revised customer journey can also be the subject of **focus groups**.

Similarly, operational staff, with considerable experience of interacting with customers, are another excellent source of **internal information** when designing the process for communicating and interacting with customers.

Harnessing the power of behavioural science to better support customer and member engagement.

The Behavioural Insights Team (BIT), in conjunction with Fair4All Finance, have worked with three community finance providers to launch a new customer engagement support guide to better improve customer engagement using insights from behavioural science.

The guide can be downloaded from the link here

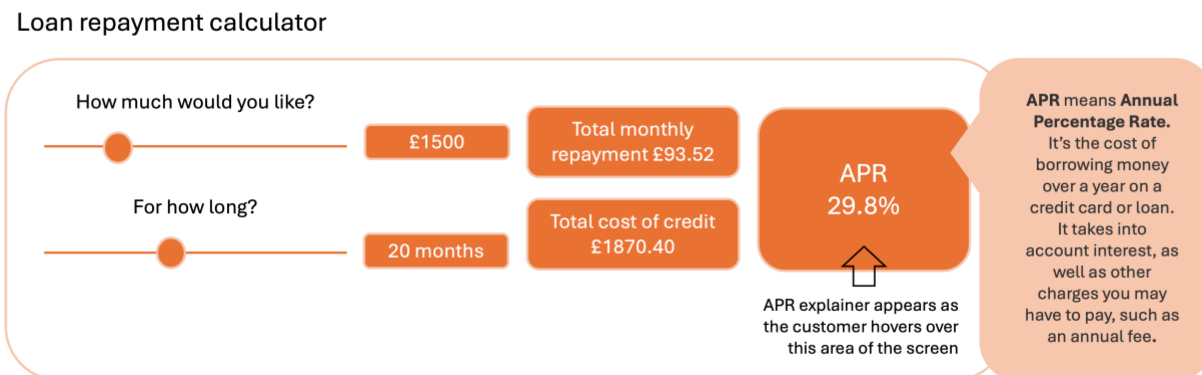
Building on our work with three lenders, this guide provides support and guidance to the wider community finance sector with practical examples of interventions that organisations can make to increase their conversion rates of eligible customers and to strengthen their customer and member communications.

In this guide you will find:

- ways to improve your online loan journeys
- advice and support on how to strengthen your customer and member communications
- how to evaluate the changes that you have made to measure improvement

A key consideration during the process of optimising a customer journey is that not everyone needs to know everything. There will be a mix of naïve and knowledgeable customers, vulnerable customers, previous customers and new customers. Therefore, the delivery of the information delivery needs to be tailored.

A good example of this is the use of "tool tips" – icons next to each high-level piece of information that a customer can click on, or small explainer windows that pop up when customer hovers over that area of the screen. These give more information for example, where the APR is stated, explain in more detail what the APR is. Likewise, clear options to receive information in other formats if that will aid customers' understanding.



Continuing with the AWCU case study, once the product's features and target market had been confirmed, AWCU's web-team created several mock ups of how they wanted to present the loan application process` to customers via AWCU's website[13].

Given that AWCU already provides loans, the web team did not start from scratch. Instead, they used a modified version of the existing loan application process to make it suitable for the new loan product. This resulted in considerable savings in time and effort compared to designing a completely new process from scratch. The main changes/amendments that the web-team had to make were:

- When a customer selected the payment holiday product, information about how the product operates had to be rewritten to explain the additional product features
- Modification of AWCU's existing pre-application questionnaire and affordability tools, to cater for erratic incomes and the operation of payment holidays. For example, income questions were modified to ask about average income over the last six months, rather than just monthly income
- A new version of the summary box that included the new product's extra features before a customer signs their agreement

[13] For this example it is assumed this is an online product only, but similar processes would be undertaken for any paper-based on in-branch process.

- A new version of the loan contract detailing the fees relating to the payment holidays (which required input from AWCU's legal advisors to ensure the wording was compliant with regulations).

3.1.5 Customer understanding (post application)

Once a customer has been granted a loan, the requirement to support customers and enable their understanding of the product does not end.

If the new product has the same features as an existing product, and is targeted at similar customers to existing ones, then Consumer Duty understanding outcome may be met via the current customer management process. However, as part of the proposition design, this should be reviewed to ensure there are no gaps requiring remediation.

In the case of AWCU, one outcome of the initial workshop (section 3.1.1) was a requirement to upskill customer services staff to educate them about the operation of the new product, which would then enable them to provide information to consumers as part of the account management process.

3.2 Accessibility

In designing a product proposition, lenders need to bear in mind the different ways in which customers with different needs access information about the product. While the majority people have no trouble accessing standard webpages, reading paper documents or making a call to customer services, there is a significant minority who require alternative access routes to obtain the information they need to understand products and services and to interact with firms.

In designing communications with customers to make them accessible to everyone, a lender should consider the following:

- **Use of plain language.** Product information, such as the terms and conditions for loan products, should be presented in simple language that is easily understood by the average consumer. Complex financial jargon should be avoided unless there is a legal requirement to use it. There is lots of evidence that many consumers do not read legal jargon before accepting agreements[14]. Conveying the key points clearly and succinctly is vital.
- **Webpage design.** Websites should be designed with a wide range of consumer needs in mind. The Web Content Accessibility Guidelines (WCAG) here, are an international standard that provides recommendations for making digital content, including websites and digital

[14] https://op.europa.eu/en/publication-detail/-/publication/45ebfd93-3d90-11ea-ba6e-01aa75ed71a1/language-en

documents, accessible to the widest possible range of people. Providing text to speech options can also be helpful

Alternative formats. Customers should have the option to receive information in formats that suit their accessibility needs. This could include providing information in large print or brail, in accessible PDFs or as plain text documents. It could also include providing information in alternative languages to be as accessible as possible within diverse communities.

Providing accessible routes to contact customer services. For example, providing text-based chats via the lender's website or offering an in-branch or home visit service for people with hearing difficulties who find it difficult to communicate over the phone

- **Staff training**. Employees who interact with customers or handle customer information should be trained in dealing with customers who have specific requirements and should be familiar with the accessibility features provided by their institution

Failure to incorporate these things into the loan application and customer management journey is likely to lead to poor outcomes for some people, and hence result in non-compliance with firms' Consumer Duty obligations.

3.3 Understanding the market and what your (potential) customers would like

To be able to design a product proposition that meets customer and business requirements, an understanding of customers and the wider market is required – what can broadly be defined as "market research." In this section we describe some of the ways that this understanding can be obtained by carrying out appropriate market research activities.

3.3.1 Customer profiling

Profiling different customer groups against existing products and services can establish the types of products that appeal to different types of customers. Profiling can be based on existing customer data held by the lender which can be augmented with third party data if desired (e.g. from a credit reference agency or marketing agency).

For the AWCU case study, the credit union had been able use their existing customer data to identify a group of customers whose financial behaviour differed from the majority, and hence would benefit from a product tailored to their specific requirements.

If a lender does not have customer data or the right customer data, then there are many organisations that can provide summarised customer profiles; that is, profiles of customer segments that don't contain personal data, but describe people with similar features and characterises to the target market, and details of the products and services that people in that segment tend to use. The Fair4All Finance Segmentation model is a practical segmentation model for people in vulnerable circumstances and Fair4All Finance can provide practical help in adopting this model. See https://fair4allfinance.org.uk/segmentation/

For example, for a credit union operating in a specific geographic region, there are organisations that can provide a postcode level view of the age, income profile, family composition, use of financial products, housing type, employment and level of education, measures of financial difficulty (CCJ penetration) and so on. This can then be used to formulate a view of the types of customers who live in the credit union's area of operation. This can in turn be used develop appropriate products for meeting these customers' needs. For example, regions that have a higher than average proportion of people on zero-hour contracts and/or part-time working might be one group considered suitable for AWCU's "erratic payer" product.

3.3.2 Surveys, questionnaires and focus groups

A good way to understand what customers want is to ask them – and in doing so provide evidence that the lender is thinking about what the customer wants in line with the Consumer Duty outcomes (Price and Value, Products and Services).

The design of any survey or questionnaire is important. This is so that it provides a representative and impartial view of what customers think. A good survey will also provide space for free form text to allow people to express thoughts and ideas beyond the scope of the original questions. In house surveys can be prepared at a relatively low cost, depending on the scope and scale, with many community finance providers achieving excellent response rates.

Focus groups are another way to obtain customer opinions. The main benefit of focus groups is that they can be managed dynamically, with the facilitator guiding the group and exploring issues that are raised during the focus group session. The drawbacks of focus groups are that they are generally quite expensive to host and can only solicit the views of a handful of people at a time. The nature of the product (consumer lending) also needs to be considered in terms of how to recruit participants who will have a genuine interest and knowledge about the product.

Focus groups and surveys can work well in combination, with an initial focus group helping to inform the type of questions to include on questionnaires and surveys. Alternatively, focus groups can be used to explore issues raised by surveys and questionnaires. For new and novel propositions, a lender may decide to engage a research agency who can provide best practice advice on unbiased research methods[15].

Another option is to have anyone involved in proposition design to shadow operational staff to experience customer interactions first hand. This often provide additional insights into how customers are thinking and behaving.

3.3.3 Market intelligence

The value of your products and services and their appeal to customers, is to a large degree, dependent upon the competition.

Good market intelligence allows a lender's products and services to be benchmarked against the wider market to support discussions around the price and value of the lender's products.

Organisations can pay to obtain market intelligence, and larger lenders may have dedicated staff whose sole purpose is to collate information about what rivals are up to. For smaller organisations, tasking someone to gather and report on best buy tables and scan the financial media say, once a month, can add a lot of value for relatively little effort.

Mystery shopping where organisations gauge the customer experience in other lending operations can also be done to really get under the skin of the entire proposition.

3.3.4 Expert opinion

It is always good practice to seek the opinions of customers directly, but the opinions of experts can, and should, inform the firms understanding of its customers. Staff often have years of experience that can be extremely valuable. This can include senior leaders, but the views of operational staff who frequently deal with customers can often provide the most valuable insights and can be very welcome opportunities for frontline staff who value the chance to contribute to proposition design.

3.3.5 Demand planning & macro economics

As well as understanding who the potential customers are in terms of their geodemographics and what type of products they want, market research should aim to identify how many customers there are who want the products under consideration. This then drives discussion around what proportion of that market is attainable given market competition, and hence, produce realistic estimates of the number of customers that can be expected to be apply for the new product. This is important because the one-off costs associated with new products can be considerable. Therefore, unless enough customers take up

[15] There is a lot of science behind the design of questionnaires and the running of focus groups, to ensure that the results are representative and unbiased. If organisations don't have extensive in-house experience, then it is advisable to seek external expertise before undertaking these exercises.

the product, significant losses could result.

Consideration should also be given to micro and macro-economic factors. For example, at the micro (local) level, if a credit union predominately serves members working in a particular profession, the employment trajectory for that profession will significantly impact the demand for the credit unions services. At the macro-economic level, how the economy is doing, house prices, unemployment and interest rates may also impact demand.

3.4 Marketing requirements under the Consumer Credit Act

Product marketing is an important way for lenders to let consumers know what they can offer them. Any FCA regulated entity providing credit must comply with the Consumer Credit (Advertisements) Regulations 2010[16] when advertising their products. With a few exceptions[17], the regulations cover all lending to individuals, both regulated and unregulated, including credit union lending.

The general requirements of the regulations are that every credit advertisement shall:

- Use plain and intelligible language
- Be easily legible (or, in the case of any information given orally, clearly audible), and
- Specify the name of the advertiser

Marketing in the context of the regulations covers all types of marketing and advertising, both direct and indirect. To put it another way, at any point where a consumer comes into contact with a firm, if that contact mentions that the firm is offering loans, then the regulations need to be complied with.

The FCA has subsequently provided further guidance, in that advertising must not be misleading or make inappropriate claims. For example, advertising that a product will "clear your debts" when in fact the product simply involves transferring the existing debt to a new loan[18]. Likewise firms should not imply that a loan is guaranteed or that no credit checks are performed before a loan is granted[19].

There are also a number of terms and phrases that must not be used in any credit advertisements except in very specific circumstances. For example "Overdraft"" can only be used if the advertised product offers an overdraft on a current account. "Interest-free" can only be used if the total cost of credit is no more

[16] Much of this regulation is captured within the FCA handbook under CONC 3.3 - 3.5 for regulated lending not secured on land.
[17] For example some business lending to sole traders
[18] FCA (2014). Consumer credit firms must raise advertising standards, says FCA. https://www.fca.org.uk/news/press-releases/consumer-credit-firms-must-raise-advertising-standards-says-fca#:~:text=The%20FCA%20examined%20over%20500,missing%20or%20difficult%20to%20find. Accessed 22/08/2023/
[19] FCA (2022). FCA warns businesses to stop misleading credit adverts to protect consumers. https://www.fca.org.uk/news/press-releases/fca-warns-businesses-stop-misleading-credit-adverts-protect-consumers. Accessed 22/08/2023.

than the equivalent cash price of the product or serviced being financed. See Section 10 of the regulations for a complete list.

3.4.1 Adverts that don't include information about the cost of credit

Where a firm's advertising does not include anything about how much a loan will cost (such as the APR or the typical repayments), advertisements only need to comply with the general requirements around the use of plain language, legibility and the name of the advertiser.

For example, if a credit union decided to put up posters on billboards in their local area, advertising something along the lines of:

> "Need an unsecured loan of between £1,000 and £7,500? Then come and talk to the All Welcome Credit Union and we'll see if we have a product that is suitable for you!"

Then no further information would be needed to be included. Note that stating the loan amounts available does not reference the cost of the loans and therefore the advert is acceptable as is.

If the advert implies that the credit might only be available to people who are credit impaired (such as having CCJs or defaults), or that there is some incentive to apply for credit (such as a free gift or a discount) then the more rigours requirements, as described in the next section, apply.

3.4.2 Adverts that include information about the cost of credit

Once marketing materials contain anything about the cost of a credit product then the regulations require some additional information to be provided. This includes any mention of the products APR, the cost of the credit, repayment amounts and any fees. Once this type of information is included, then the regulations require all of the following information is provided[20].

- The Representative APR21: This is the APR that at least 51% of customers are offered.
- A representative example. This shows the repayment terms for a typical loan being offered. The example must include the following standard information:
  - the loan amount (or credit limit for a revolving product)
  - The interest rate being charged and if this is fixed or variable or both. If more than one interest rate is applied, then the highest rate should be used.

[20] This is in reference to unsecured loans. There are additional/different requirements for secured lending.
[21] There is a specific way that the APR and total cost of credit must be calculated. These are specified in the consumer credit act, and included in the FCA Handbook (CONC App 1.2.6 R.)

- Any charges or fees in addition to interest payments
  - The total cost of credit
  - The representative APR%
  - The loan term
  - The regular repayment amount
- The standard information contained in the representative example must be:
  - Specified in a clear and concise way
  - Accompanied by the words "representative example"
  - Presented as a whole (e.g. not on separate pages) with each item of information being given equal prominence
  - Given greater prominence than any other information relating to the cost of the credit in the credit advertisement[22], or any incentive to take out the credit (such as a free gift)

For lenders offering high-cost short term credit, then additional requirements apply, as detailed in the FCA handbook (CONC3.4).

Some useful examples of non-compliance and bad practice have been reported upon by the FCA on several occasions. For example, see the FCA publication: FCA warns businesses to stop misleading credit adverts to protect consumers | FCA

3.5 Data protection considerations

All personal data that is gathered, held and processed by organisations needs to comply with data protection legislation, as defined by the UK Data Protection Act 2018. This sometimes referred to as GDPR or UK GDPR.

Three of the key requirements of GDPR (there are others) are consent, lawful purposes and transparency. An organisation must obtain an individual's permission to process their personal data and only to process that data for lawful purposes. In doing this, they must clearly explain what those purposes are.

To comply with GDPR, organisations must present customers with a privacy statement that the customer must accept before processing of their data commences. This will often occur at the point when a new customer begins a loan application but may occur earlier in the relationship if personal data is required

[22] There is an exception relation to ancillary services – see section 8.1 of the regulations

pre-application. For example, for credit unions, the privacy statement provided when they first become a member may cover the use of their data for subsequent loan applications.

Another example is where lenders offer a "pre-approval" option. A pre-approval is where the lender makes an informal, non-binding, assessment of the customer before they formally apply. In this way, they can tell the customer if they are likely to be approved before they apply. The most common way this is done is for the customer to consent to a "soft" credit search which provides the lender with access to their credit history, as maintained by a credit reference agency. "Soft" in this context means that no record of the credit search is maintained by the credit reference agency.

The typical areas covered by a privacy statement for a personal loan are:

- The following personal data
  - Name, address and date of birth
  - Contact details
  - Credit reports
  - Banking details, including income and expenditure information
  - Employment history
- For the following purposes
  - Assessing the customer's eligibility for a loan (underwriting)
  - Customer verification and fraud prevention
  - Communication with customers
  - Manging customer accounts
  - Cross selling of other products and services (internally and/or externally)
  - Regulatory compliance
- And covering
  - Data security
  - Retention periods
  - The customer's rights, and who to contact if they have an issue.

An example of a data privacy statement is provided in Appendix A. See also the Data Maintenance and retention module of the Guide for further data protection information.

4 Business requirements

In this section we focus on the business requirements aspect of a loan proposition. The covers a range of areas that includes:

- Alignment with risk appetite
- Business objectives. Usually the goal will be for the income generated to exceed costs and hence generate a positive return for the lender. However, this isn't always the case if the lender has funds to support community lending. In this case, a degree of loss may be acceptable. However, it is still important to understand the profit/loss position to ensure losses do not pose a business risk and are in line with expectation.
- Operational practice. This covers what systems, policies and processes need to be modified to allow processing of the new product

4.1 Alignment with risk appetite and business objectives

A lender's credit risk appetite sets the level of credit risk that a business is willing to accept. This is expressed using measures such as arrears, defaults and write-off rates. In designing a product proposition it is important that the product under consideration is within risk appetite.

To do this, and to meet their business objectives, organisations need to form a view of the risk profile of the target population and maintain a lending policy that achieves the following goals:

1 Ensures that risk appetite is not exceeded

2 Overall, the revenues generated by customers meet business objectives

It is important to note that these two things are not the same. Risk appetite represents a back-stop position beyond which the business will not go. For example, the risk appetite may state that the portfolio default rate should never exceed 10%. However, that's the overall position. It may be that profits are optimised if default rates are maintained at say, 8% Also, there may be sub-sets of the portfolio with default rates higher, sometime significantly higher, than 10%, but this is offset by better performing customers with default rates far lower than 10%.

If there is a misalignment between the risk appetite, business objectives and the target market, then this often manifests itself as an unacceptably high decline rate, with far fewer customers being granted loans than expected. This is because a robust lending policy should be formulated to meet both of the aforementioned goals and if the applicant profile is worse than this, then most applications will be declined. Things can also go the other way. If the product is over-priced or too low risk, then it won't attract the customers it is targeted at. They'll go for products that offer them better value elsewhere. For both these reasons, it's important to gain view of the overall risk profile of the target market so that a view on the expected accept and decline rates can be arrived at. In the community finance sector, customer visibility of the propositions is also a major challenge, and overcoming this can be vital in connecting demand to well designed propositions.

Fair4All Finance supports a program to raise awareness of the community finance sector working with an external media and communications agency and using customer case studies provided by the sector to generate coverage across a range of print, digital and broadcast media. As part of this work, we have also produced a Marketing and PR toolkit that can be accessed here.

In the AWCU loan case study, discussed earlier, AWCU identified a group of existing customers that had a similar risk profile in terms of default (3+ arrears) rates, but who had a tendency to enter early arrears more frequently due to their erratic incomes. Consequently, they were able to make reasonable estimates about the accept and decline rates based on analysis of their existing loan book and use their existing lending policy with only minor modifications.

If historic loan performance data is unavailable, then external data and/or expert opinion can be utilised. A Credit Reference Agency, for example, can create anonymised samples of customer records to match almost any customer profile. The lender then undertakes analysis of the CRA supplied sample as a proxy for the customers it expects to lend too, and this then informs any changes to lending policy.

The Financial Conduct Authority (FCA) is exploring the use of synthetic data for testing proposition designs. Synthetic data works by generating statistically realistic but artificial data that can be used to create advanced modelling techniques and train Artificial Intelligence (AI) models without compromising individual privacy or data protection laws. The FCA hosts synthetic data sets within its permanent digital sandbox for organisations to join tech sprints to test propositions using the data. More information on synthetic data can be found in the FCA's report Using Synthetic Data in Financial Services here

Obtaining external data can be very useful, but also expensive. If a lender does not have the resources to purchase data, then the backstop position is to rely on expert opinion to come to a view on what the risk profile of the target audience is expected to be.

Further details of risk appetite and lending policy are contained in the Risk Appetite and Lending Policy components of the Guide.

4.2 Costs and revenues

When designing a credit proposition, the cost of developing the product and delivering it to the market needs to be considered right at the start in conjunction with the revenues that are expected to be received. This will often be an iterative process that is updated as the proposition evolves, and further information comes to light. The initial proposition may need to be refined several times to create the right balance between a product that provides excellent value for the customer with one that generates sufficient returns for the business.

4.2.1 Costs

When it comes to costs there are two types of cost the need consideration:

- **Set-up "One-off" costs**. These are expenses that cover the design and launch of the product, and are typically incurred before and lending occurs, that is, prior to product launch
- **Running costs.** These are costs that are incurred once the product is up and running to process applications and manage customer accounts

Table 5 details the set-up costs that are typically involved in launching a new loan proposition.

Table 5. Set-up costs

Cost	Description
Market research	• Understanding the market to support the design of a product that meets the needs of customers • Establish the size of the market and what market share is realistic, and hence what the expected product demand will be
Development	• Internal time to cover the design stage • Concept development and working up details of proposition • If appropriate an initial proof of concept or pilot stage which could involve a period of manual parallel running to test out a limited volume of loans as part of a minimum viable product test • Iterative refinement of the proposition
Legal and compliance	• Legal documents such as credit agreements, privacy statements and website content will need to be updated • Audit processes updated to include the new product • Regulatory reporting may require review and change • Additional permissions may need to be sought from the FCA

	• Agendas for governance forums may need to be updated
IT Changes	• Websites, loan origination, customer management and debt recovery systems will need to be updated
Operational changes	• Different types of processing may be required for the new product. This will include product specific wording in comms, as well as different customer management processes
Policy updates	• The organisations policies, particularly around credit risk and affordability will need to be reviewed, and updated if appropriate
Training and development	• Updating of staff training about the new product and any product specific features that required staff to learn about or deal with differently from the current product range
Portfolio MI (Management Information)	• Updates to the organisations reporting will be required to ensure that product performance is assessed and managed appropriately

In some cases, these costs may be absorbed within BAU activities. For example, if the lenders website is maintained by a fixed team, then changes to the website many be incorporated within the teams existing work list. In this situation there are two ways that organisations measure costs. One is to treat it as a zero cost under BAU. The other is to base cost estimates on the hours required to do the work associated with the new product.

Table 6 provides the costs that are typically involved in running a loan proposition

Table 6. Running costs

Item	Description
Funding	The money used to lend to customers has to be "bought" from somewhere. For credit unions funded by member shareholdings, this cost is represented by the dividend that credit unions pay to their members. For other types of institution, funding costs are either the cost of paying interest on deposits, or the fees charged by commercial lenders such as investment banks
Marketing	On-going marketing campaign costs to ensure a steady stream of new customers

Staffing	This covers the salaries and other costs associated with any extra staff that are needed to manage accounts thought the product lifecycle
IT costs	Additional storage, processing and licensing costs associated with managing the additional customers for the new product
Data costs	Cost of acquiring data such as credit reports, fraud prevention services and accessing open banking data
Provisions & Bad Debt	This covers the expected bad debts that will arise from lending activities. Often this is the largest costs that lenders incur when providing consumer credit

4.2.2 Revenues

Table 7 shows the sources of revenue for a loan product

Table 7. Revenues

Item	Description
Arrangement (documentation) fees	These days, most loans don't include arrangement fees, but some do. These are upfront fees that lenders charge to arrange a loan. Sometimes the fee is charged during the application that is paid there and then. More commonly the fee is added to total debt and repaid over the loan term (hence incurring interest)
Interest	Interest is the biggest revenue stream for most loan products. The interest is usually based on the outstanding loan amount at any given time. Therefore, the overall amount of interest charged each week or month will reduce over time as the loan is repaid
Commission	If a loan is being provided in conjunction with a product or service, then the lender may also receive commission on the items sold. For example, a lender may work with a car dealership to provide motor finance. In addition to the income earned directly from the loan, the lender also receives say, a 2% commission of the sale price of each vehicle from the dealership
Early repayment charges	Under the Consumer Credit Regulations 2004 lenders can charge up to 2

(ERCs)	months additional interest for early repayment before the end of the loan term.
Completion (termination fees)	As for arrangement fees but charged at the end of the agreement to cover the costs of terminating the agreement. Most loan providers don't charge completion fees
Late fees and penalty charges.	Technically a firm should not make a profit on late fees and the FCA sets a £15 limit. However, these are a source of revenue, and if a lender is including staffing and administrative costs of managing delinquent loans when it is assessing costs, then late fee charges should be included in the revenues
Additional fees and charges	There may be additional fees and charges that apply for providing services associated with the product. For AWCU, for example, revenues are generated from the payment holiday fees

4.2.3 Calculating the financial returns expected from the product

To calculate the expected profitability profile of the product, the cost and revenue figures can be compared over time to generate a long-term view. Continuing with the AWCU case study, Figure 8 shows the estimated returns that will be generated for the new payment holiday product over its first 5 years of operation. A cost and revenue model as per the table below should be prepared for each individual proposition.

Table 8. Cost and revenue model with and without NPV applied

	Year 0 (Set up)	Year 1	Year 2	Year 3	Year 4	Year 5
Sales assumptions						
Loan applications	0	6,000	10,000	10,000	10,000	10,000
New customers	0	3,000	5,000	5,000	5,000	5,000
Average loan value	N/A	4,500	4,500	4,500	4,500	4,500
Average loan term (months)	N/A	24	24	24	24	24
Product APR	N/A	15.9%	15.9%	15.9%	15.9%	15.9%
Payment holidays per customer per year	0	2	2	2	2	2
Gross revenues	£0	£2,151,000	£3,585,000	£3,585,000	£3,585,000	£3,585,000
Set up costs	£675,000	£0	£0	£0	£0	£0
Running costs	£0	£1,882,500	£3,137,500	£3,137,500	£3,137,500	£3,137,500
Net return (0% discount rate)	-£675,000	£268,500	£447,500	£447,500	£447,500	£447,500
Net return (5% discount rate)						
Cumulative return (0% discount rate)	-£675,000	-£406,500	£41,000	£488,500	£936,000	£1,383,500
Cumulative return (5% discount rate)	-£675,000	-£419,286	-£13,390	£373,177	£741,337	£1,091,965

Costing and revenue assumptions

1. Set up costs cover market research, staff time, updates to the website and a major upgrade to the customer management system to allow the payment holiday process to be applied
2. Funding costs are 5%
3. 10% of loans will end up being written off
4. There is a £15 processing fee for each application that takes into account staff time, IT and costs for open banking and a credit report
5. The average expected cost of managing a credit agreement is £45 per annum once the loan granted. This includes processing an estimated 2 payment holidays per customer per year.
6. On average, each account will be subject to an average of one late fee over the life of the product. In practice, most loans are never in arrears, and most late fees apply to repeat arrears cases and subsequent debt recovery and court costs
7. A discounting rate of 5% is applied for the purpose of calculating the net present value of future income (see below for explanation of NPV)

8 Net returns are calculated as the gross revenues, less the set-up costs and running costs

At the top of Table 8 are the sales assumptions. That is, the number and types of loans that the marketing team estimates the product will generate each year. These figures should have been informed by the analysis and market research undertaken by the lender when exploring the target market, as discussed in Section 3.3.

AWCU's policy is that any new product must at least break even within 3 years. Figure 7 contains two sets of figures for the returns that are generated. A simple view where costs and revenues are simply summed up over the five-year period is provided by the "0% discount rate" rows. The cumulative return row shows that under this calculation the product breaks even in year 2, with an estimated cumulative return of £41,000 at that point.

However, financial accounting standards often require organisations to consider the "time value of money." This means that the further into the future one goes, the less any revenues (or costs) are valued as at today. Therefore, for the purposes of financial planning, the values are increasingly discounted the further into the future transactions occur. The NPV is calculated as follows:

$$\mathrm{NPV}(\pounds X) = \pounds X \;/\; (1+A)^n$$

Where:

$\pounds X$ is the amount.

A is the discount rate charged per reporting period

n the number of periods over which to discount

As an example, £1,000 of revenue received in 3 years' time, based on a 5% discount rate has a net present value of:

$$\mathrm{NPV} = \pounds 1{,}000 \;/\; (1+0.05)^3 = \pounds 883.84$$

AWCU finance applies a 5% discount rate for calculating NPV. Applying this to the expected returns gives a different answer as to when the product breaks even, in year 3. This is acceptable and on this basis the board is willing to approve the product launch.

4.3 Sensitivity analysis and risk assessments

The planning process described in the previous sections has focused on the best estimate case, informed by market research to estimate customer demand, with addition estimates of the operational costs of meeting that demand. To put it another way, costs are estimated as £X, revenues as £Y, based on a number of assumptions such as how many customers will be granted loans and the average value of those loans.

Prior to the work getting underway to develop and launch the product, these figures are largely estimates. In reality they could be higher or lower than estimated. In particular, demand planning is notoriously fickle, and the estimated number of successful loan applications will have a wide margin of error due to uncertainties such as how the economy will turn out and what competitors are doing.

During the business planning phase, it is therefore prudent to undertake sensitivity analysis and maintain a risk register.

Sensitivity analysis is about looking at what might happen if the assumptions around the product proposition differ from what are expected. Some examples of the types of sensitivity that it is prudent to perform are:

- **Supplier costs**. For example, what happens the cost of open banking or credit searches increases by say, 25%?
- **Interest rate risk**. If funding comes from sources other than members' deposits, such as via a bank loan, how would the profitability of the product look if interest rates rose by 1,2,3%?
- **Customer demand.** What will the financial impact be of demand being say, 10,25,50% more or less than expected?

When it comes to risk assessment, some of the sensitivity analysis may support risk identification such as lower than expected demand creating the risk of substantial financial losses, but there are other risks that need to be considered. These will be specific to the lender and the product being offered, but some typical risks associated with a new product proposition include:

- **Regulatory risk.** Changes to regulations that mean that costs will increase, or the product no longer becomes viable under UK regulations. There is also the risk that if a product is unusual in some way that it is subsequently found to be non-compliant with current regulation
- **Legal risk**. The risk that the new product breaks the law in some way, causing litigation against the firm from customers
- **Reputational risk.** Poor outcomes for customers damage the lenders reputation
- **Operational risk**. The risk that systems and process break or don't work properly. For example, if demand is higher than expected, this might overwhelm the application processing system causing it to crash
- **Staff risks.** There is a chance that critical staff members leave at key points in the project, resulting in delays or errors, and hence increased costs

5 Post launch monitoring

Getting a new product proposition off the ground and being taken up by customers is a great achievement. However, following launch it is important to undertaken monitoring to gauge how well the product is performing and to identify any post launch issues that require remediation. Monitoring can broadly be split into two types

- **Portfolio monitoring**. This covers the operational and financial performance of the new product against marketing plans and risk appetite. This includes volume of applications, number of loans offered and declined, arrears, default and write-off rates over time and so on. This type of monitoring is discussed in detail in in the Portfolio MI component of the Guide
- **Customer monitoring**. This covers monitoring customer satisfaction and ensuring that the product is providing good outcomes in line with Consumer Duty. This will include items such as monitoring customer complaints, on-going product benchmarking, value assessments, customer feedback and so on. If we continue with the example of AWCU and their "erratic payer" product, then this would include monitoring if and how customers were using the payment holiday feature, and what subsequently happened to those customers. For example, did the holiday feature help them avoid arrears (good outcome) or acting merely to delay arrears (poor outcome)? Customer monitoring is discussed in detail in the Consumer Duty and Complaints handling component of the Guide

Based on the results of the monitoring, lenders will modify their polices to address any shortcomings identified. For example, if default rates are higher than expected then lending policy will be tightened. If customers have raised FOS complaints about some aspect of their treatment, then these cases are reviewed and operational customer management revised accordingly.

6 Appendices

6.1 Appendix A. Example of a privacy statement for a new loan customer

The following is a fictional example of a privacy statement for a personal loan application. It is not intended as a legally compliant template but to provide a general guide as to the general format, structure and contents that a typical privacy statement contains.

Privacy Statement for All Welcome Credit Union loans

All Welcome Credit Union are committed to safeguarding your privacy and ensuring the security of your personal information. This privacy statement outlines how we collect, use, share, and protect the information you provide us with when applying for a personal loan. By engaging with our services, you consent to the practices described in this statement.

The Information we Collect and how we use it

We collect personal information such as your name, date of birth, contact details, banking information, employment details, and credit history. This information is essential to process your loan application and comply with regulatory requirements.

We use your information to assess your loan eligibility, process your application, communicate with you, and manage your account. This includes verifying your identity, undertaking credit searches with a credit reference agency and complying with our legal and regulatory obligations.

We may use automated decision making in processing your personal and financial information to make lending decisions. You have the right to request a manual review of the accuracy of any decision made if you are unhappy with it.

Information Sharing

We may share your information with credit reference agencies, fraud prevention agencies, open-banking providers, debt collection agencies, government agencies and regulatory bodies and other service providers. We share this data when you apply for a loan and at regular intervals during the course the loan you have with us. This is to enable us to fulfil our contractual and legal obligations.

Your information will not be sold to third parties for any purpose.

Data Security

We employ robust security measures to protect your data from unauthorized access, alteration, or disclosure. Your information is stored securely and accessed only by authorized personnel.

Your Rights

You have the right to access, correct, or delete your personal information. You can also object to or restrict certain processing activities. To exercise these rights, please contact our Data Protection Officer at [DPO Email/Contact].

Retention Period

We retain your personal information only as long as necessary to fulfil the purposes outlined in this statement, or as required by law. This will be usually for a period of 6 years after the completion of the loan agreement you have with us. However, we may need to retain your data for longer than this to address any complaints or for other regulatory reasons.

Updates to Privacy Statement

This privacy statement may be updated periodically to reflect changes in our practices. We encourage you to review this statement to stay informed about how we protect your information.

For more details about our data handling practices or to submit a privacy-related inquiry, please contact our Data Protection Officer at [DPO Email/Contact].

Date of Last Update: [Date]

[Credit Union Name]

[Credit Union Address]

[Phone Number]

[Website]

[Email]

Data Protection Officer:

[Name]

[Email]

[Contact Number]

By using our services, you acknowledge that you have read and understood our privacy practices outlined in this statement.

Note that the above is a fictional example and is relatively short. It covers all the key areas required, but a real privacy statement might include extra information to support customers. For example, more information about the operation of credit reference agencies, open banking and so on. These detailed explanations are not absolutely required, but if they provide the customer with greater understanding then that supports good customer outcomes.