Good Practice Lending Guide

RM03 Application Process

May 2024

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1 Introduction

The Good Practice Lending Guide is intended to support retail lenders in running their credit risk management processes effectively and in line with UK regulatory requirements. Each component of the Guide describes one area of risk management in detail.

This Application Process Good Practice Guide discusses the stages of the application process. Each stage contains references where applicable to the relevant good practice components which provide a greater level of detail for that element.

This guide is not prescriptive, and it does not provide a single view on how organisations should order or carry out their application process. Each lender will have a different view on what assessment should be prioritised and some of this may be driven limitations of size and capabilities of the lender.

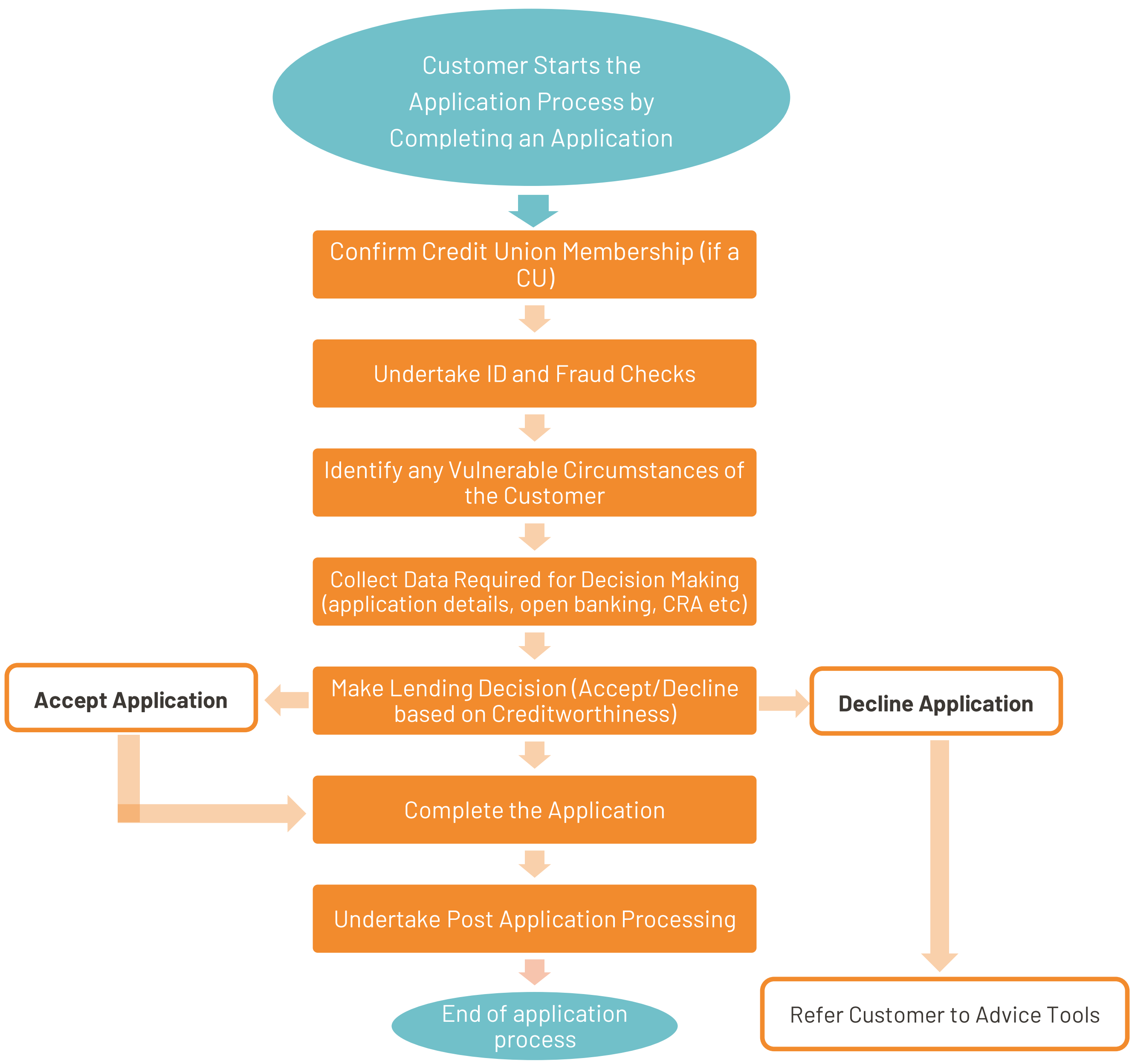
1.1 Scope of This Document

The scope of this document, as part of the Good Practice Lending Guide, is the Application Process. The document is primarily focused on the application process for Credit Unions, but most elements are generally applicable to all types of lending institution.

The remainder of this document describes the customer journey from initial enquiry through to completed application. This includes the different routes into the organisation, such as direct or via a broker, and the data that lenders should obtain about applicants at each stage of the journey. For example, data that applicants should provide themselves on the application form and what should be obtained via open banking, a credit report, or other sources. This document also covers the importance of having the right decision points at the right stage in the customer journey, and the use of decision engine software to manage the key decision points in the application process.

2 The application process

Figure 1 shows the typical application process for a personal loan and contains links to allow you to move around between the sections you are most interested in.



The ordering of the steps in the application process can vary. For example, some lenders may seek to identify vulnerable customers before undertaking verification and fraud checks. However, all steps should exist in a well-designed application process.

3 Stage 1: undertake preliminary checks

When an individual reaches out to a credit union, either online or in person, directly or via a broker, it is important that checks are in place early to verify the individual meets the criteria to be a member and they are who they say they are.

It is best to carry out these checks at the earliest stages before requesting lots of information from the individual that might be time consuming and difficult for them to gather. In addition, external checks, such as credit checks, are time consuming, costly and may affect the customer's credit report. Therefore, it is best to carry out as many preliminary checks as possible before reaching these stages, especially if they may be declined by the lender based on these.

Once these pre application checks have been carried out and approval in principle is granted, the individual can then move forwards to the next stage of the application process.

As part of these preliminary checks, a lender needs to check the individual's membership, verify their identity, check for fraud, and assess if the individual has any vulnerable characteristics.

3.1 Confirming Credit Union membership

For Credit Unions, the first step a lender should take in the pre-application process is to ensure that the individual is applicable to be a member of the credit union.

If the individual is a current member, then lenders should ask the individual for personal information such as name, address, and membership number to confirm their existing membership.

If the individual is not a member currently, then the lender should ask the individual questions pertaining to the lender's specific membership criteria (the common bond) alongside personal information such as name and address. For instance, an employment-based credit union such as a Credit Union for Police might want to include questions around employment and employment type to ensure the individual is working for the police.

The following details the information that may be requested at pre application stage. Individuals may provide this information via an online application form on the lender's website, over telephone, via a broker or face-to-face in a branch.

Personal Information:

- Name
- Date of Birth
- Nationality
- Current Address, with details of move in date
- Up to two previous addresses, with details of move in and move out date
- National Insurance Number

Employment Information:

- Is the individual employed?
  - Full, Part Time, zero contract hours
  - Job Type
  - Start Date
- Is the individual unemployed or retired?
- Is the individual in the armed forces?

This information is not exhaustive and can vary depending on the membership criteria of each lender, but the questions asked at this stage should be enough to determine if the individual meets the lenders membership criteria.

Credit unions should understand that circumstances are different for everybody, and they should be flexible in their approach. For instance, if the customer cannot provide a permanent address because they have been 'sofa-surfing' or have had periods of homelessness, the credit union may be willing to accept a temporary form of proof of address such as the friends address where the customer is staying.

If the customer is unable to meet any of the required forms of proof and the customer fails, the high-level verification checks then the credit union should be understanding that the customer may be in vulnerable circumstances and look to provide further support to help the customer. Please refer to Section 3 for more information on how to assess and treat vulnerable customers and Section 6.3.2 for information on the decline process.

If the customer can provide the required information but they are not suitable to become a member of the credit union, for example they don't meet the common bond requirements, then the lender should recommend the individual search online for a credit union applicable to them[1].

If the individual is already a member, then the lender should ask if there have been any changes to their circumstances. If not, then the information already held on the lender's database should be used, otherwise, the questions noted above are applicable.

If the individual in not already a member and meets the membership criteria the lender should direct the individual to the relevant application form to formally become a member.

3.2 Undertaking ID verification and fraud checks

As part of the application to become a new member of a credit union or to for an existing member to obtain a loan, the lender must undertake both verification and fraud checks:

- **Verification.** This is concerned with confirming that the customer is who they say they are and that they live at their stated address
- **Fraud.** This is concerned with identifying individuals who are trying to obtain funds but have no intent to repay the money

Verification of the customer's name and address is a powerful fraud prevention tool, but additional fraud checks should also be undertaken to identify other types of fraud that can occur.

Please see RM06 Customer Verification and Fraud Prevention for more details.

3.3 Identification of vulnerable circumstances

The FCA states that a 'vulnerable customer' is someone who, due to their personal circumstances, is especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care.

It is important that an individual's circumstances are assessed as early in the journey as possible to cater for any vulnerable circumstances a customer may have.

Regardless of the method of application, the lender should look to understand the following information, to assess the vulnerability of the customers circumstances. Not all these items will be direct questions, but it is important for the lender to be alert to these pieces of information as they can help the lender assess the vulnerabilities of the customers circumstances.

[1] The Association of British Credit Unions Limited (ABCUL) has a Find Your Credit Union website, which allows individual to search for credit unions.

Information	Further Details
Does the customer have caring responsibilities other than children?	
Does the customer have any physical or mental health problems?	This can include a physical disability such as difficulty walking, hearing, or seeing. Or it could involve a mental health disability. For instance, if the individual is trying to apply for credit on the telephone and they inform the employee that they have difficulties hearing, then the lender could suggest an in-person meeting where they could offer something to aid the conversation such as a hearing loop. This is to ensure a good outcome for the customer. However, if the customer has highlighted difficulties with mobility, it could be best to organise a virtual meeting via telephone or online.
Does the customer have any addictions, such as gambling, drugs, or alcohol?	This may mean the customer is less resilient and/or capable of deciding about the lending agreement.
Is the customer suffering from high levels of debt and/or financial difficulties?	This can affect the resilience of the customer.
Is the first language of the customer English?	If the customer’s first language is not English, then this may lower the capability of the customer to understand the product.
Are there any signs that the customer is being forced into the application?	Employees should be alert to signs of coercion. It is not enough to just ask the question. For instance, if the application is being made over the phone and the employee dealing with the case can hear the customer being talked through the answers by another party, then this may be a sign of coercion.
Any other	Lenders should ensure open communication to ensure the customer is able to highlight anything additional to the information already provided.

Vulnerabilities can be more difficult to assess via online applications and over the phone which is why the Vulnerability Register Service can be valuable when assessing the vulnerability of the customer. Please see the following the next section for more detail.

3.3.1 Vulnerability Register Service (VRS)

The Vulnerability Registration Service[2] (VRS) is a useful database for assessing a customer's circumstances. It is a not-for-profit organisation which provides a central, independent register for people with vulnerable characteristics. It allows individuals or someone acting on behalf of the individual i.e., with a power of attorney, to register the individual's circumstances as vulnerable and/or that they wish to be pre-declined. In addition, if the individual wishes to flag the type of vulnerability, they can flag this against several set categories.

The details supplied are shown on the register for 3 months, after which users can ask for their details to be removed if they feel their circumstances have changed. In which case, no lender or organisation will be able to see this information. The sole purpose of the VRS is to provide a snapshot of the individual circumstances at a given point in time, it is not there as a historic record of previous points in time.

Lenders can get access to this information to help them understand the vulnerability of a customer's circumstances up front and avoids a customer having to continually explain their circumstances to each lender. There is a fee associated with becoming a member, however, it provides valuable insight into the customer's circumstances early in the lending agreement.

Please see RM07 Consumer Duty and Complaints Handling, for more information on how to assess and treat vulnerable customers.

[2] Vulnerability Registration Service - VRS

4 Stage 2: assessing customer application data

Once the following checks have been completed:

- the customer is confirmed as a member (for credit unions)
- fraud and ID checks have been passed
- any vulnerable circumstances have been identified

The customer can now move onto the main application stage for the credit agreement. This stage includes understanding what credit the individual is looking to obtain and gathering information around the customers income and expenditure which can be used in the credit worthiness checks later in the application process.

It is important to capture all this information regardless of whether the customer has an existing product, as an individual's circumstances might have changed since they last applied for credit.

4.1 Application credit agreement details

It is key to understand the credit agreement the customer is applying for. The following information is required from the customer:

- **Product**: Lenders may have multiple products, with different terms and conditions[3]
- **Amount**: The amount the individual wants to borrow
- **Term**: The term length, for instance, 12 months

[3] It is noted that some lenders will ask customers how much they want to borrow over what term, and then suggest the most appropriate product for them once they have assessed the customer's creditworthiness.

- **Reason for the loan**: This can be used by the lender to check the product and the term selected will give the best outcome for the customer. It can also be used as part of the risk assessment.
- **How will the payments be made**: eg Standing order, Cash, Payroll Deductions
- **How does the customer want to receive the money**: eg Bank Account (Bank transfer), Cash, Cheque.
- When does the customer want to receive the money: eg as soon as possible or on a specific date.

The lender can use this data to calculate how much the individual would need to pay back over the course of the agreement and how much this would be as a monthly payment (this could also be weekly or another length of regular payment).

Is it important that the lender check that the product selected by the customer provides a good outcome for them. For instance, based on the information provided the customer may be better off taking a shorter repayment term which would save them a lot in terms of interest payments. Conversely a longer repayment term, with lower monthly payments may cost more overall, but is more affordable. It is the duty of the lender to make the customer aware of this other product and the pros and cons for each.

The lender must communicate the payment amounts, interest accrued and total balance, to the customer and ensure they understand the implications of the possible agreement, before moving onto the next part of the application[4]. At this stage there has been no creditworthiness assessments, so the application is not approved at this stage. It is here to ensure that the customer understands the agreement that they have applied for. For instance, once the customer sees the monthly repayment amounts, they may decide that they would rather borrow over a longer period to reduce the costs each month.

The lender must get the go ahead from the customer, either in writing, verbally or via an online check box, that they want to proceed with the application process.

4.2 Personal details

Once the application information around the credit agreement is captured, the lender will want to capture several details about the customer. Some of this information may already have been captured in the preliminary checks so will not be re-captured at this stage. The types of information will vary from lender to lender but below is a list of information the lender may want to capture at this stage:

Data	Further Information
Name, Date of Birth, Address, Nationality	This should already have been captured at the preliminary stage or should already be held on the database if the customer is a current member.

[4] Specific requirements for presenting information about loans is provided in the Consumer Credit Act.

	However, if the customer does not pass the ID verification and manual underwriting ascertains differences in the information now compared to when they last applied, then this information should be updated on the customer records.
Employment, Employment Type, and length of time in employment	This information has been referenced at the preliminary stage of the process to understand if the customer is applicable for membership. However, if employment type is not a membership criterion for the credit union, then the question may not have been asked, therefore it is important to capture at this stage. It is important to understand the employment status of the individual from a risk perspective as it is likely that a customer who is in full-time employment is lower risk than someone who is unemployed or has irregular income. Alternatively, a lender may currently have no appetite to lend to individuals who are unemployed, despite having done so in the past. Therefore, employment is not a membership criterion, but it can lead to a hard decline at the lending policy stage. If this is identified early in the application process, then no further assessments are required, and the application process can be stopped which saves undue time, cost, and effort on behalf of the lender and customer.
Number of Dependants	This number of dependants can factor into the affordability of the customer.
Bankruptcy or Debt Relief order in the last 6 years (Y/N)	It is commonplace for lenders to decline customers who say yes to any of these questions. These questions might be involved in the Credit Risk Assessment (Section 5.1) as a 'hard' decline rule; however, it can be beneficial to assess whether these are present earlier on in the application. Especially if they are a reason to decline the applicant regardless of any other information provided. If the customer answers 'No' to these questions, then they can move on to the next part of the application process, where their answer will be verified as part of the Credit Risk Assessment. This will involve a search with one or more of the Credit Reference Agencies.
County Court Judgement or IVA in the last 6 years (Y/N)	
Criminal Conviction (Y/N)	

4.3 Income and expenditure

Income and expenditure information must be requested from the individual at the application stage.

Income and expenditure are verified and used later in the process as part of the final affordability assessment of the customer. It is good practice to gather this information earlier in the application process so a rough calculation of affordability can be carried out. This can give the lender comfort that when a full affordability assessment is carried out, which can include CRA and/or Open Banking search, the customer has a high chance of being accepted. This is important as these searches leave a 'hard footprint' on an individual's credit report which can affect their credit score. The lender should only carry this check out under circumstances where they think the customer will be approved for affordability. This is especially important for credit union customers who tend to be less financially resilient and may not have the strongest credit scores.

Please see section 5.2 for information on the affordability assessment.

The following information should be requested from the customer:

Income:

- If the customer is employed: The net monthly salary or equivalent, with any deductions applied.
- If the customer is unemployed or retired: Any universal credit, benefits or pension information should be provided as their income information.
- The customer should be asked if their income is likely to reduce over the term of the loan applied for. For example, is the customer expected to retire, or be made redundant?

Expenditure:

- Credit Commitments: Their repayment amounts to cover debt repayments for current credit commitments such as Mortgages, Credit Cards, and Loans.
- Contractual Payments: The payments the individual must pay at a specified date. It does not include payments relating to credit commitments outstanding. Examples of these include rent, utility bills and council tax payments.
- Other Payments: The amount the individual spends on other things such as transport and food, which are necessary living costs but are neither repayment amounts to cover outstanding credit commitments nor contractual monthly payments that must be met. Cash withdrawals, cash back and bank transfers to individuals are difficult to categorise into a particular segment of expenditure as it is unknown what these payments are used for. It is conservative to include these in non-discretionary other payments.

- Discretionary Expenditure: Any information on spending costs that are not necessary but do occur, such as restaurant or cinema payments.

Please see RM05 Affordability Lending Policy, for more detailed information on the income and expenditure data lenders should request for the customer.

5 Stage 3: collate data for decision making

At this point in the customers journey, the lender should have:

- Confirmed as a member (for credit unions)
- Undertaken ID verification and fraud check
- any vulnerable circumstances have been identified
- Gathered sufficient information about customer employment, income, and expenditure.

If the individual already has a relationship with the lender, then information around the performance of the previous loan has been attached to the application. Likewise, if the customer has savings history and current account behaviour, information about these products, can also prove useful.

6 Stage 4: make the lending decision

Lenders must carry out the relevant creditworthiness checks to ensure that the credit risk of the individual is within their risk appetite and that the customer can afford to make the repayments.

- **Credit Risk** is the risk of financial loss resulting from granting a loan. Credit risk is usually associated with customers who do not keep to their contractual repayment terms and fall into arrears, default and are eventually written-off. This is sometimes referred to as default risk or loss risk.
- **Affordability** is the risk of the customer not being able to make the agreed repayments. More precisely, in taking out a loan is the customer borrowing beyond their means, which might result in in financial difficulty and a poor outcome for the customer.

A lender should first assess the credit risk of the customer before going on to assess their affordability. The reason being the affordability element of a creditworthiness assessment is the point where the most questions/discussions with customers tend to arise. Therefore, a customer is likely to feel that their time has been wasted if they spend time discussing their income and expenditure, only to be told that they were rejected on the grounds of credit risk.

Up until this point, there have been no credit reference agencies or open banking searches. It is important to get the consent of the individual applying for the loan to access their credit report and/or use open banking, where applicable. Lenders who require these checks to take place may decline the applicant if consent is not provided.

These will then be discussed in the following sections.

6.1 Credit risk assessment

As part of a credit risk assessment, lenders will look to use information that the customer has provided at application, and lenders own data alongside data from Credit Reference Agencies and in some cases Open Banking data. It is important to note that Open Banking data has more value in the affordability assessment, which will be discussed in the next section.

Credit reference agencies (CRAs) hold public information and private account performance and search data. CRAs can also derive their own data from these public and private sources. Please refer to RM08 Credit Reference Agency Reporting for more information on the types of data CRAs hold.

Lenders can use this information within their lending policy to determine the outcome of the customer from the perspective of credit risk:

- **Hard Decline:** For instance, a credit search with a CRA finds a CCJ from 2 years ago associated with the customer. The customer has not declared this on the application form, but this would overrule the stated information and the customer would be declined. The customer should go no further in the application process.
- **Referral:** These are rules where the case must be reviewed by an experienced loan assessor to come to a final decision. For instance, the credit score is not sufficient to be a straight accept but neither is it too low to be deemed a high credit risk. The outcome of a referral may either be an accept or a decline. If it is an accept, then the customer will move forward to the next stage of the application process.
- **Auto Accept:** Usually, these are exception-driven, firing only at the end of the process if no decline or refer rules are hit.

It should be noted that credit searches can negatively impact customers who have a 'thin' credit file. A 'thin' file is where an individual has a limited amount of information or data. For instance, a young individual who hasn't had time to build up a credit history or individuals who have recently moved to the country so there is limited information held on them.

If a credit search is performed and the information held on the customer is too limited for a decision to be reached the lender should refer the customer to resources that they can use to improve their credit history. If the credit search shows the customer is in financial difficulties and is a reject based on the policy rules, the lender should provide the customer with advice on external debt advice websites that they can visit to get help with their current financial circumstances. Please refer to Section 6.3.2 for information on the decline process.

Only customers who pass the credit risk assessment automatically or after referral, will then move onto the affordability assessment part of the application process, as discussed in the following section.

Please refer to RM04 Credit Risk Good Practice Guide for a more detailed explanation on the good practices for Credit Risk.

6.2 Affordability assessment

An affordability assessment is important, and failure to do an adequate assessment can lead to the FCA taking formal action against the lender.

At a high level, an affordability check involves.

- Deriving and verifying the individual's income
- Deriving and verifying the individual's expenditure
- Applying stresses to the income and expenditure amounts to understand the resilience of the customers' affordability.
- Calculating the overall affordability using the following equation

Affordability = (Income – Expenditure) + Stress Factor

Income and expenditure values were stated by the customer earlier on in the application process, please see section 3.3. However, it is now important that the lender verifies the information provided and carries out a formal detailed affordability assessment. There are several data sources a lender can use to do this, and these are discussed in detail in the RM05 Affordability Good Practice Guide. At a high level, the data sources include the following:

- Open Banking
- Credit Reference Agencies
- Bank Statements
- Payslips or other, such as universal credit or pension details

This data can then be used to verify the income and expenditure items that the customer has provided and to calculate the monthly affordability amount. Where the values cannot be verified by the data sources used, the application should be referred to a loan assessor. This may then involve more manual underwriting to verify the income and expenditure.

If the income and expenditure can be verified then the next step is to calculate the maximum exposure amount, with minimum required buffers, where the affordability must be over a certain amount to be deemed affordable. The equation is as follows:

Maximum Exposure Amount = Monthly Affordability Calculation * Loan Term

Where Monthly Affordability Calculation must be greater than the minimum affordability threshold.

This maximum exposure amount can then be compared to the credit agreement amounts that the individual is trying to obtain to decide whether to accept, refer or decline the application.

If the loan is deemed unaffordable but close to the threshold so has been referred, then based on the affordability calculation the lender could consider offering a longer-term loan, if this is within their risk appetite, product offering, and meets the customer's financial objectives.

If the loan is deemed affordable and all other check have been completed, then the applicant can move onto the final credit agreement stage.

Please refer to RM05 Affordability Good Practice Guide for a more detailed explanation on the good practices for Affordability

6.3 Lending Decision

Once the lender has carried out all the checks for the application, the decision must be made as to whether the customer is an Accept or Decline for the loan.

6.3.1 Accept

If the customer is accepted then the lender must go onto complete the application, which is discussed in more details in Section 7.

If the customer is declined for the loan, then the lender must ensure this information is delivered to the customer in a clear and empathetic manner.

6.3.2 Decline

If the application is declined it is the responsibility of the lender to ensure the customer understands why they have been declined. However, the responsibility of the lender should not stop there. Lenders should offer information on the organisations a customer can turn to for advice and help on areas such as debt and gambling problems. Not only that, but there are also tools such as benefit and budgeting calculators and resources that provide information on how to improve a 'thin' credit file, which can be offered to help improve the customers circumstances. This part of the process is important to ensure a good outcome for the customer and to try and prevent the customer from seeking out irresponsible lenders to borrow from.

Please refer to RM16 Debt Advice and Financial Literacy for a more information on how lenders should help a customer who has their application declined.

7 Stage 5: complete the application

Once the lender has carried out all the checks for the application, and the customer has been accepted then, the lender should inform the customer. This may take place via email, over telephone or face to face but should always be followed up with formal written documentation to clearly state all the terms and conditions.

The customer should have all the information they need to make an informed decision.

The lender should:

- Explain each aspect of the product including the pros and cons.
- Reiterate all areas of the products terms and conditions.
- Ensure they are confident the customer understands all the aspects of the product, and this is evidenced, before agreeing to the product. The customer should also understand their role and responsibilities in the lending agreement.
- Ensure there is open communication between the employee(s) and the customer so the customer can ask any questions and they are encouraged to do so.
- The lending agreement should be transparent and avoid using any technical language and jargon. For instance, the lending agreements should contain clear, straightforward information on items such as prices, interest rates, fees, and charges, cooling-off periods, total cost of finance and any other associated terms and conditions of the lending agreement.

Despite assessing vulnerabilities at the start of the application process, it is important to continue to be aware of any forms of vulnerability throughout the entire process and this extends to the final agreement stage. Ensuring that there are no signs of the customer being coerced into accepting the final credit agreement.

Please refer to RM07 Consumer Duty and Complaints Handling for more information

8 Stage 6: undertake post application processes

The lender has now accepted the final agreement and the loan has been provided to them by their preferred method, whether that be cash or a bank deposit.

Lenders must publish information on their internal complaints handling procedures, including the role of the Financial Ombudsman, and ensure the consumer is aware of the availability of this information in writing at, or immediately after the point of sale.

Please refer to RM07 Consumer Duty and Complaints Handling for more information on the complaints handling procedure.