Good Practice Lending Guide

RM05 Lending Policy Affordability

May 2024

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Navigating through this document

The Contents table above gives a way to navigate to each specific section.

Affordability calculation gives the individual's income left over each month after expenditure has been deducted, stress factors are included, and buffers applied. This document describes all the steps and includes some worked examples of the calculation. The diagram below illustrates the components of the process at a high level, and contains links to allow you to move around between the sections you are most interested in.

Income	Expenditure	Calculations and data
Types of Income	Types of Expenditure	Data sources
Income history and changes	Expenditure history and changes	The affordability calculation
Minimum income and tolerances	Buffers and Tolerances	Worked examples
Stress testing the income	Expenditure stress testing	FOS complaints upheld

1 Introduction

1.1 Why are affordability assessments important?

Lending matters to millions of households and it is important that lending is fair, responsible, and carried out with dignity, ensuring a good outcome for the customer. When the need of the customer aligns to the motivation of the lender it can transform lives, smooth income flows, and reduce financial distress.

The ethos of cooperative finance delivered through the credit union movement and community finance is intended to improve lives. Making sure that lending is affordable is central to that ethos and is at the heart of the Fair4All Financial Affordable Credit Code of Good Practice.

This guide is designed to help lenders lend well. It is important for a lender to document and evidence the steps they take to assess the affordability of an individual.

Failure to do so adequately can lead to the FCA taking formal action against the lender. Additionally, it can lead to complaints from customers who feel it was irresponsible of the lender to lend to them, with these being upheld by the Financial Ombudsman Service (FOS) if there isn't sufficient evidence to the contrary.

Credit unions must follow the credit unions sourcebook (CRED) [1]and credit union core lending is classified as unregulated. Consequently, credit unions are not subject to the Consumer Credit Sourcebook (CONC) unless they engage in regulated lending activities. However, by following similar principles to those in CONC, which are discussed throughout this document, it allows the lender to clearly evidence they are "Treating Customers Fairly" in line with the FCA's Principles for Business.

Failure to evidence an adequate affordability assessment can lead to:

- Formal action from the FCA against the lender
- Complaints from customers about the lender to the FOS
- Costly compensation payments and refunds to the customer from the lender
- Reputational damage to the lender

[1] Further information about the regulatory landscape can be found in the "Introduction to the Good Practice Lending Guide" document

The FOS can impose compensation payments on the lender and other payments such as refunds on the interest payments received from the individual during the agreement, which can be financially costly to the lender. There is also the reputational damage to the lender caused by these cases, even where an exemption to lenders paying FOS fees may apply[2]

Please refer to Appendix C for some examples of customer complaints assessed and upheld by FOS due to failings in the affordability assessments undertaken by credit unions and other lenders. It is worth noting that some of these judgements draw heavily on the expectations set out under CONC not CREDS and they are included in this guide to draw attention to the way the regulators are interpreting good practice for community lenders for both CDFIs and CUs. This guide has been produced to enable community finance lenders to follow good practice with regards to affordability assessment, and to take reasonable steps to ensure they are not lending irresponsibly.

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 affordability, and provided consulting support to enhance them in many instances. This guide reflects our intention to document what good practice looks like on affordability to share the insight that has been developed for specific lenders more broadly.

The guide is also a reflect in part, on the significant role that poorly managed affordability processes have had on the lending market and can contribute to the exit of many providers due to upheld affordability complaints.

1.3 Purpose of this document

The Good Practice Affordability Lending Policy Guide is intended to support Community Finance lenders in managing their customers' affordability assessment effectively and in line with UK regulatory requirements. Specifically, these cover the different approaches that can be adopted to calculate income and expenditure for customers, to establish the affordability of the products that customers are applying for.

[2] There is an existing exemption for FOS fees for credit union core lending for example

Each lender will have a different approach, however, it is important that firms clearly define and comprehensively document their affordability policy and set up appropriate governance and oversight processes.

The Affordability Lending Policy Guide is not prescriptive. It is not intended to provide the definitive view as to how organisations should assess affordability. However, it describes industry standard good practice approaches to affordability lending policies that are widely used across the credit industry, to ensure compliance with FCA requirements. The FOS section on Unaffordable Lending complaints states that they will ask questions such as "did the lender complete reasonable and proportionate checks to satisfy itself that the borrower would be able to repay any credit in a sustainable way?" FOS go on to clarify that in this context, "Reasonable and proportionate" is measured more in relation to the customer's circumstances, rather than in relation to the size or complexity of the lending organisation. See Appendix for the criteria FOS use to determine "Reasonable and proportionate".

The Affordability Lending Policy Guide covers the affordability lending policy principles that are 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 struggle to obtain it. For example, not-for-profit lenders and credit unions.

Organisations can use the Affordability Lending Policy Guide in one of two ways:

1. As a reference manual, to help them enhance their own affordability lending policies and to provide assurance that there are no gaps or shortcoming
2. To support new organisations in setting up appropriate affordability lending policies

In this document we describe how the more complex cases should be referred to a more experienced or senior person who has the authority to approve – this could be the Head of Credit for example. Depending on the size of the organisation, there may be only one person who reviews loan applications, or there could be a small team with a "supervisor" who has more authority.

The Affordability Lending Policy Guide should be assessed and periodically reviewed[3] to ensure the effectiveness of the policies and procedures and to ensure the lender is complying to policy and procedures documented. If it is found that the lender is not complying, then appropriate measures should be taken to address this.

[3] Most policies are reviewed annually but they can be reviewed more frequently if required.

The focus of this document is Affordability Policy. However, there are obvious links to other areas of lending, such as Risk Appetite, Monitoring, CRAs etc. These will be signposted within the relevant sections throughout this Affordability Lending Policy guide.

2 Scope

This document is the Good Practice Guide for Affordability Lending Policy.

The scope of the Affordability Lending Policy Guide is to ensure the customer's affordability assessment is effectively managed and the customer can make the repayments under the agreement[4] . 'Repayment' refers to repayment of capital, payment of interest and any other charges relating to a credit agreement.

2.1 Regulatory guidelines

CONC applies to certain lending types such as unsecured loans and revolving credit products but does not apply to credit agreements secured on land, such as Mortgages.

The FCA published CONC5.2A - Creditworthiness assessment[5], in November 2018. CONC5.2A covers the following:

1. The risk that the customer will not make repayments under the agreement by their due dates (this is sometimes referred to as credit risk), and
2. The risk to the customer of not being able to make repayments under the agreement in accordance with CONC 5.2A.12R (referred to as 'affordability risk' in this section)

This document covers point 2, relating to the assessment of the affordability risk of the individual.

The FCA guidance states: *"CONC 5.2A.20R to CONC 5.2A.25G contain rules and guidance in relation to the factors that should be taken into account in an individual case when deciding how much information is sufficient for the purposes of the creditworthiness assessment, what information it is appropriate and proportionate to obtain and assess, and whether and how the accuracy of the information should be verified."*[6]

[4] CONC 5.2A.12 - CONC 5.2A Creditworthiness assessment - FCA Handbook
[5] CONC 5.2A Creditworthiness assessment - FCA Handbook
[6] CONC 5.2A.8 G

The FCA make clear that their approach is principles-based as opposed to prescriptive. It is up to the lender to make a reasonable assessment in each individual case. CONC 5.2A.24 gives some high-level principles on how to determine the proportionality of the information that must be considered, and the steps taken to evaluate the information, stating that a more thorough assessment would be required, either:

a in the case of more expensive credit or credit that is higher in amount; or

b where it is known that the customer's financial situation is such that the credit may be expected to have a more significant impact.

Point (b) is particularly relevant for the Community Lending sector, supporting people in vulnerable circumstances, and aligns with the FOS view on proportionality.

A lender should assess the affordability of an individual, irrespective of whether the individual has borrowed from the lender previously. If there is clear evidence that the individual's circumstances have not changed since the previous affordability assessment, the lender should decide what is appropriate for the affordability assessment.

2.2 Affordability overview

Throughout this document references are made to "Net Monthly Income" and "Monthly Expenditure." However, it is acknowledged that different time periods could apply depending on the specific product features, such as if weekly or fortnightly repayment terms are offered. A lender should look to use the Net Income and Expenditure across time periods applicable to their products.

Lenders should also consider the customer's income pattern – for example if the applicant is self-employed with irregular income, then reviewing their income over a longer period is important even if the lending term is short. Please refer to the section on Income History for further information.

At a high level, an affordability assessment relies on the following:

- **Income**: Net Monthly Income should be derived, and the applicant's stated income should be verified using data sources described below
- **Evidence of Expenditure**: This captures the outgoings of the individual, to ensure that the individual can still afford to make any contractual obligations and any necessary cost of living payments
- **Stress Testing:** Considering applying stresses to income and expenditure is good practice to assess the overall impact on the individual's affordability

Affordability = (Income – Expenditure) + Stress Factor

These topics will be discussed in more detail within this document. There are detailed sections on Income, Expenditure and Stress-testing, together with some worked examples.

A glossary of terms and a list of key regulations referenced by the Affordability Lending Policy Guide are detailed in the Appendices.

3 Data sources

In addition to the information that the individual provides when applying for credit, the following data sources can be used to inform and/or verify the individual's income and expenditure amounts to assess their affordability:

- Open Banking
- Bank Statements
- Payslips
- Credit Reference Agency (CRA) data
- Statistical Data - Office for National Statistics (ONS) data or equivalent

Appendix D provides more general information about each of these sources.

The next sections go into more detail about how each source can be used for income and expenditure assessments.

4 Income

4.1 Individual income

The individual's income is a key component of the affordability calculation. Lenders must take reasonable steps to determine the current income or to make a reasonable estimate of the current income of the individual.7

The net monthly income can be based on multiple sources of incomes and consideration should be given to all income sources, such as primary salary, second job salary, pensions, and benefits. If these are not included in the income calculation, then the affordability of the customer will be understated. Please refer to Section 4.6 for further information on benefits.

Individuals that have irregular or non-standard forms of income are more difficult to assess from an income calculation perspective, therefore, it may not be possible to calculate the affordability of these individuals in the standard format. Examples of irregular and non-standard forms of income include:

- Self-employed Incomes
- Cash-based Incomes
- Individuals working on zero hours contract or on flexible contracts
- Some benefits such as Universal Credit can vary in the amount paid each month, due to the way income is offset

It is deemed more suitable to refer these cases to a more senior member of the team, where they can engage with the customer directly and seek out the relevant information to assess their affordability. It remains important in these cases that the information captured, and steps taken as part of the process are well evidenced and documented.

It important to note that for those individuals who are drawing on their pension or student loan as a source of income, these pension and student loan amounts should form part of the income calculation.

[7] CONC 5.2A.15R

Otherwise, the pension contribution and student loan repayment will be a deduction from the income along with other deductions such as tax and national insurance to derive the net monthly income.

It is important to attempt to verify any stated incomes provided by the individual. The FCA provides guidance that states:

"For the purpose of considering the customer's income under CONC 5.2A.15R, it is not generally sufficient to rely solely on a statement of current income made by the customer without independent evidence (for example, in the form of information supplied by a credit reference agency or documentation of a third party supplied by the third party or by the customer)."[8]

THE FCA guidelines allow the individuals income to be verified using Credit Reference Agency (CRA) information. The FCA states:

"A firm must base its creditworthiness assessment on sufficient information:

1 *of which it is aware at the time the creditworthiness assessment is carried out;*

2 *obtained, where appropriate, from the customer, and where necessary from a credit reference agency,*

and the information must enable the firm to carry out a reasonable creditworthiness assessment "[9]

Irrespective of the permitted usage of CRA data, depending on the lenders risk appetite, if the individual does not give consent for Open Banking and cannot provide the relevant bank statements the lender could choose to reject the application.

Open Banking is the most comprehensive data source for calculating income and should be the preferred option if possible.

A lender must:

- Take reasonable steps to determine the current income or to make a reasonable estimate of the current income of the customer to verify the stated income

A lender should consider:

- Which data sources they are comfortable using to assess the income of the individual
- All income sources, not just primary salary, in the income calculation

[8] CONC 5.2A.16G
[9] CONC 5.2A.7R

- The treatment of the individual if the income cannot be verified by the available data sources:
  - Refer to a more experienced person?
  - Reject the application and consider what other support can be provided[10]
- The treatment of individuals with irregular incomes

4.2 Joint income

Where there are joint borrowers, each with an income, it is possible to include both incomes as part of the affordability assessment. However, consideration should be given to the affordability of the individuals in isolation[11].

The most prudent assessment of affordability would consider the individuals in isolation and base the affordability on the main applicant or lower of the two incomes to ensure the repayments could be met in the event one individual was solely responsible for the obligations of the joint borrowers.

A lender should consider:

Whether to include the main and joint applicants' expenditure in the income assessment

The justification for using either both or 1 of the applicants' income

4.3 Household income

A recent review by the FCA clarified that household income can be considered, provided that the firm is reasonably satisfied that this will be available to the borrower for repayment of the credit12. It is expected that lenders will be able to demonstrate, if challenged, that it was reasonable for them to include household income in their calculation of affordability for a given case.

A lender should consider:

Whether to include household income in the income calculation

[10] Declines best practice research provides tips on dealing with decline applicants
[11] CONC 5.2A.30 G
[12] PS18/19: Assessing creditworthiness in consumer credit: Feedback on CP17/27 and final rules and guidance (fca.org.uk) – Section 2.2

4.4 Guarantors

The lender should not consider any guarantees or other forms of security as part of the affordability calculation.

The FCA states *"When considering affordability risk, the firm must not consider the existence of (or the intention to provide or request the provision of) any guarantee or indemnity or other form of security."*[13].

A lender must:
Not consider the existence of (or the intention to provide or request the provision of) any guarantee or indemnity or other form of security

4.5 Savings and other assets

In line with the FCA guidelines, savings and other assets should not be included as part of the overall income amount unless this was specifically indicated, by the individual, as a means of repayments.

The FCA states that the firm must consider the individuals ability to make repayments under the agreement out of "*savings or other assets where the customer has indicated clearly an intention to repay (wholly or partly) using them*"[14]

The lender must then assess if it is reasonable for the individual to use savings and or other assets as payment.

"If the customer intends to make repayments (wholly or partly) using savings or other assets, the firm must take into account:

1. the purpose for which the savings or assets are or will be held;
2. the likelihood of the savings or assets being available to make repayments under the agreement; and
3. any significant adverse impact on the *customer's* financial situation of using those savings or assets."[15]

[13] CONC 5.2A14 R
[14] CONC 5.2A.12 R (3)
[15] CONC 5.2A.13 R

A lender must:

Not include savings and assets unless relevant conditions are met

4.6 Benefits

Benefits should be considered as part of the individual's income, so as not to understate the affordability of the individual.

It is important to ensure only benefits that will be available throughout the whole lending agreement are included. For instance, Job Seeker's allowance is initially only available for 6 months so to factor this into a 24-month lending agreement would overstate the affordability of the individual for the remaining 18 months.

Similarly, Child Benefit is payable to people responsible for bringing up a child who is under 16, or under 20 if they stay in approved education or training. If your customer is relying on Child Benefit to be able to afford their new loan, then it is good practice to ask how old the child(ren) are currently.

Fair4All Finance's research on payroll and benefit deduction lending can be found here.

There is also a strong body of evidence that many benefit recipients do not receive the full value of the benefit that they are entitled to because deductions are taken by the DWP. It may be worth lenders understanding why some of these deductions are taken as part of a lending decision eg if someone has already received a budgeting or budgeting advance loan from the DWP or if they are making loan repayments via the ELDS scheme via their benefits. Further information on what Fair4All Finance are doing to help people maximise their income is available here.

A lender should consider:

The inclusion of benefits in the income calculation

Which benefits to include in the calculation

Whether benefits are expected to continue through the life of the loan

Advising customers to ensure they are claiming all they are entitled to

4.7 Income history

It is good practice to assess a minimum of 3 months' transactional information. If the customer is in regular employment, this is often sufficient history to use, however the lender may wish to review income, where possible, across 12 months and then take a more recent period to calculate the average income to include as part of the affordability calculation.

If the customer is in receipt of irregular income, for example self-employed, lenders should look at 12 months of income history, to get a complete picture of the customer's income pattern. Some types of work are more seasonal, for example a gardener may make more money in Spring-Autumn, and less over Winter, so taking a full year's income data would give a better view of their longer-term income.

Based on the lender's risk appetite and constraints, where a choice is available, the lender should select the number of months' worth of banking history they are comfortable to use to make an income assessment. The lender should select at least 3 months.

A lender should consider:

When using Open Banking or Bank Statements, the number of historic months' worth of transactional data to assess

4.8 Minimum income

Lenders may wish to set a required minimum income to be considered as a borrower, for example the minimum gross income value could be set at £18k. However, this value would depend on the lender's risk appetite.

The lender must ensure they continue to consider the affordability of the individual despite the minimum income level being met.

A lender should consider:

Whether to set a minimum income at application

How much this minimum income should set at

4.9 Changes to income

Considering potential decreases in income

The lender must consider any foreseeable reductions in income[16] over the course of the agreement. Not taking this into account could lead to an overstated affordability of the customer. increases in the customer's future income may be considered but evidence this will occur during the agreement should be provided.

If there is no evidence that the income will reduce over the course of the agreement, stress testing can be carried out to ensure that the individual can continue to make the payments even during unexpected changes in circumstances. Please refer to Section 6 on Stress Testing for more information. This stress testing is particularly relevant currently, given the cost of living and impacts of inflation and possible recessionary pressures.

Considering increases in income

Lenders should be cautious when looking to build in future increases in income. They would need to ask the customer for specific evidence of any increases the customer mentions, for example a letter from their employer confirming an upcoming pay rise or bonus payment.

Another example could be for people returning to work following parental leave. The customer's current salary could be statutory minimum maternity pay which is only 90% of their current salary. So, if they are returning to their previous job, their salary will be about to increase back up to 100%. Or the customer may have been on leave for longer than the 39 weeks covered by SMP, in which case they may not currently have any salary at all. Lenders should ask the customer about their specific circumstances and obtain any necessary confirmation such as a job offer letter, or a letter from the customer's employer confirming their return from leave.

Lenders should not build in any increases in income for which there's no evidence – for example if the customer hopes to have a pay rise, but this is not confirmed by their employer, it would be unadvisable to build this theoretical pay rise into the affordability calculation.

Lenders should also consider the term of the loan when looking at the timing of any increases in income. Perhaps the customer has a new short-term contract job for the next 6 months and is applying for a loan with 24-month term. The lender should establish whether the customer will still be able to afford the loan following the end of their temporary contract.

[16] CONC 5.2A.15R (3)(4)(5)

A lender must:

Include foreseen decreases in income during the term of the agreement in the income calculation

A lender should consider:

The option to include foreseen increases in income over the duration of the agreement

What evidence to request from the customer regarding increases in income

The timing of any increases, in conjunction with the length of the loan

Another example would be a loan for Christmas expenses. The lender should carefully consider a loan that would cover longer than a year to avoid financial stress in the run up to the following Christmas.

4.10 Income tolerances

It is necessary to verify the stated income of the individual and this verification can be based on defined tolerances. For instance, if the customer-stated income is 120% of the income calculated or estimated from other sources (eg bank statements, open banking), it signals an over-inflated income. In scenarios like this it is deemed good practice to send this case to a more senior member of the team for further review where they may consider alternative sources of data or treatment of the individual. If the income cannot be verified by a more experienced person, then the applicant may be rejected.

Alternatively, if the income value has been derived via open banking or bank statements but it cannot be verified then the lender may consider using the lower of the stated income vs the derived income for the most prudent calculation of income.

A lender should consider:

The tolerance levels to apply when comparing the stated income submitted by the borrower vs the derived income (this is applicable when using Open Banking, Bank Statements and Pay slips to derive the income level)

The treatment of the individual if the income tolerance threshold is not met

4.11 Income summary

Open banking is the most comprehensive data source to use for verifying the income value for use in the affordability calculation. Open banking should be the preferred choice of the lender if possible and some lenders won't lend to anyone who does not consent to open banking.

Open banking allows the lender to choose up to 12 months' worth of transaction data in order derive the individual's net monthly income. This income can then be verified against the stated income using a set of tolerances, bespoke to the lender.

Enabling the lender to have sight of the verified income has the following benefits:

- Allows the lender to apply a minimum floor to the verified net monthly income.
- Allows the lender to incorporate foreseen changes to the verified net monthly income.

If the income cannot be verified using open banking due to lack of consent or lack of data, then the next step should be to source bank statements, which provide a similar type of data.

Open Banking whilst very helpful is not infallible. Many individuals prefer operating in cash and withdraw sums making dashboard analysis of their spend more difficult. Some people operate a linked prepaid card (eg Revolut) to control aspects of their spending.

Bank statements can be used in isolation or alongside open banking (to infill the limitations of open banking), to derive and verify the income of the individual.

Bank statements allow the lender to choose 1 or more months' worth of transactional data, depending on the number of bank statements the individual can provide, and the lender's policy. This income can then be verified against the stated income using a set of tolerances, bespoke to the lender.

As per Open banking, the lender has sight of the verified income which allows the lender to apply a minimum floor to the verified net monthly income and incorporate foreseen income changes to the verified net monthly income.

The disadvantage of bank statements over and above open banking is the information presented in bank statements is not categorised. Therefore, income streams, especially where there are multiple sources can be difficult and time consuming to consolidate.

If the individual's income cannot be verified using either Open Banking or Bank statements due to lack of consent or lack of data, then the lender may wish to use payslips.

Payslips are only suitable for verifying the individual income stream that are salary driven. Payslips cannot provide information on other income producing avenues outside of salary, so an individual's net monthly income that includes other income streams cannot be verified against payslips in isolation.

The lender can choose 1 or more months' worth of payslips, depending on the number the individual can provide, and the lender's policy. The net monthly salary can be verified against the stated net monthly salary using a set of tolerances, bespoke to the lender.

The lender has sight of the verified net monthly salary which allows the lender to apply a minimum floor and incorporate foreseen salary changes to the verified net monthly salary.

If the individual's income cannot be verified using either Open Banking, Bank statements or Payslips due to lack of consent or lack of data, then the lender may wish to use a CRA.

CRAs can be used to verify the individual's stated income. The CRA will compare the stated income to the income they hold on the bureau. The CRA will provide the individuals record to the lender stating it is either verified within tolerance or not verified. In addition, an income confidence level is provided back which informs the lender to level of confidence the CRA has in the income amount they hold. It is important to note that the lender does not get sight of the derived income held on the bureau and does not get to set bespoke tolerances, both of which are limitation of CRA data for assessing the income.

If the stated net monthly income is verified, then it allows the lender to use the stated income and apply a minimum floor and incorporate foreseen income changes to the net monthly income.
If the individual's income cannot be verified using either Open Banking, Bank Statements, Payslips or CRA due to lack of consent or lack of data, it is likely the lender would reject the individual's application.
It should be noted that **Other Statistical Data** (ONS for instance) does not provide income information so cannot be used to verify the individual's income.

A lender should consider:

Which data sources they have access to for the income calculation.

What level of information they are comfortable using

All income sources, not just salary, in the income calculation

The treatment of the individual if the income cannot be verified by the available data sources.

Reject the application?

Whether to include household income in the income calculation

The treatment of individuals with irregular incomes

Whether to include the main and joint applicants' income in the income assessment.

The justification for using either both or 1 of the applicants' incomes

Inclusion of benefits in the income calculation

Which benefits to include in the calculation

The minimum income requirement, if any, at application

How much this minimum income level should set at

When using Open Banking, Bank Statements or Payslips, the number of historic months' worth of transactional data to assess

Whether to include foreseen increases in income over the duration of the agreement

The tolerance levels to apply when comparing the stated income vs, the derive income. This is applicable when using Open Banking, Bank Statements, and payslips to derive the income level

5 Expenditure

5.1 Individual expenditure

Lenders **must** take reasonable steps to determine the amount, or make a reasonable estimate, of the individual's current non-discretionary expenditure. [17]

Non-discretionary expenditure is the financial and contractual obligations for themselves and/or a dependant. The FCA states that Non-discretionary expenditure *"includes payments needed to meet priority debts and other essential living expenses and other expenditure which it is hard to reduce to give a basic quality of life. It also includes payments the customer has a contractual or statutory obligation to make, such as payment obligations arising under a credit agreement or a mortgage contract."* [18]

Non-Discretionary Expenditure can be split into three main categories:

- **Credit Commitments**: This relates to the individual's committed repayment amounts to cover debt repayments for credit commitments such as Mortgages, Credit Cards, and Loans. The individual must continue to make these payments each month and this should be subtracted from the net monthly income
- **Contractual Payments:** This includes payments that 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:** This includes expenditure such as transport and food, which are necessary living costs but are neither repayment amounts to cover outstanding credit commitments or contractual monthly payments that must be met. Cash withdrawal, cash back and bank transfers to individuals are difficult to categorise into a particular segment of expenditure as it's unknown what these payments are used for. It is conservative to include these in non-discretionary other payments

Discretionary Expenditure relates to non-essential spending that is incurred by an individual.

[17] CONC 5.2A.17 R (2)
[18] CONC 5.2A.17R (5)

The FCA guidance refers to non-discretionary expenditure only in the affordability calculation. However, depending on the lender's risk appetite, both discretionary and non-discretionary expenditure amounts can be included as deductions in the affordability calculation.

Whilst including discretionary expenditure in the affordability calculation gives the lender sight of how much the individual could afford to borrow with no change to their current circumstances, it is reasonable to assume that if an individual was struggling to make their repayments, the individual would be able to reduce the discretionary element of their expenditure. In which case, the lender's affordability decision could consider a reduced discretionary expenditure amount. A buffer (lower limit) for the discretionary expenditure should be considered in this case to account for potential unforeseen expenses. Please refer to Section 5.6 for further details.

Certain expenditures, identified using open banking, may be indicative of addictive behaviours and/or customer vulnerability. Evidence of excessive gambling expenditure, or regular usage of BNPL facilities is usually taken as a warning sign. Consequently, regardless of the affordability calculation for the individual, it would be considered prudent to refer the individual to a more experienced person for them to fully consider the individual's specific circumstances, if their gambling expenditure is deemed to be excessive.[19] Many lenders will set a threshold of 20-25% of income as a trigger point for referral.

Credit Search data, available in a customer's CRA files, will show whether the customer has made recent applications for credit. The customer may have been declined by the other lender(s) or they may have been accepted and have a new loan that may not yet appear on their credit files. Lenders should discuss this with the customer to understand what their current situation is regarding other borrowing they may have recently obtained.

Open banking provides the most comprehensive view of an individual's expenditure and should be used as the preferred measure if it is available.

In circumstances where it is not possible to derive the expenditure amount using open banking, bank statements, Payslips and CRAs due to lack of consent or lack of data then the FCA guidelines allow statistical data to be used. The FCA states:

"For the purpose of considering the customer's non-discretionary expenditure under CONC 5.2A.17R, the firm may take into account statistical data unless it knows or has reasonable cause to suspect that the

[19] There could be genuine reasons for a high gambling spend being recorded. Therefore, the emphasis should be on understanding the individual's circumstances before a final lending decision is made.

customer's non-discretionary expenditure is significantly higher than that described in the data or that the data are unlikely to be reasonably representative of the customer's situation."[20]

Statistical data, such as ONS Family Spending Survey data[21], provides a detailed breakdown of the average household expenditure broken down into the following categories:

- Food and non-alcoholic drinks
- Clothing and footwear
- Household (net), fuel and power – Including rental payments.
- Household goods and services
- Health
- Transport
- Communication
- Recreation and culture
- Education
- Restaurants and hotels
- Miscellaneous goods and services

This information is further broken down by groups such as income decile band and region. Given the focus is on community lending, the lender may wish to consider the lower income decile bands when selecting the relevant expenditure values.

There are detailed breakdowns of each of these items and the lender should categorise these items into non-discretionary (Credit Commitments, Contractual Payments, Other Payments) and discretionary expenditure, based on the lender's risk appetite and customer base. Justification for these choices should be evidenced by the lender. It is worth noting that some of the FOS complaints which have been upheld are based on a very granular view of the customer's expenditure. For example, lenders should not assume that non-discretionary payments only include mortgages, council tax and other credit commitments - but should also include other payments such as mobile phone, car insurance etc.

When using estimated household data, consideration should be given to the individual's household composition. For instance, it is more likely that an individual sharing a house with 1 other adult will pay

[20] CONC 5.2A.19 G (1)
[21] Family spending in the UK - Office for National Statistics (ons.gov.uk)

less than 100% of the household expenditure compared to an individual living alone. If the lender permits the use of statistical data for the affordability calculation a weighting to the estimated household expenditure amount may be required. Please refer to Section 0 for more information.

If the individual has stated a higher expenditure amount or the lender has reasonable evidence to suggest the individual has higher rates of expenditure than that suggested through statistical data, then the lender should take this into consideration[22]. A prudent assessment would consider the higher of the two values.

Statistical data such as ONS is not able to provide estimated data for non-discretionary credit commitments that the individual may incur. The lender would need to rely on other sources to verify these expenditures, such as open banking and CRAs.

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[22] CONC 5.2A19 G (2)

Reject the application?

Whether to include cash withdrawal, cash back and bank transfers to individuals as part of the non-discretionary expenditure other payments category

Using the lower income bands to derive the estimated statistical data

How best to treat average household level expenditure values

5.2 Joint expenditure

Where there are joint borrowers then the FCA guidance suggests that the non-Discretionary expenditure amounts for each borrower should be calculated. As per the individual expenditure, it is good practice to include both Non-Discretionary and Discretionary expenditure for the joint borrower.

If the lender chooses to include joint incomes in the affordability assessment, then both borrowers' expenditures should also be included[23].

"Where the firm has under CONC 5.2A.12R(2)(b) taken into account income received by the customer jointly with another person or income received by a person other than the customer it should also take into account non-discretionary expenditure relating to that other person. In those circumstances, references in this section to non-discretionary expenditure of the customer should be taken to include the non-discretionary expenditure of the other person.

When using estimated household data, as per individual income, consideration should be given to the household composition. If the lender permits the use of statistical data for the affordability calculation a weighting to the estimated household expenditure amount may be required. Please refer to Section 5.4 for more information.

A lender should consider:

Given that the treatment of joint applicants' expenditure should be consistent with that of the income calculation, a lender should consider:

The inclusion of the main and joint applicants' expenditure in the expenditure assessment?

The justification for using either both or 1 of the applicants' expenditures

How best to treat average household level expenditure values

5.3 Household expenditure

As mentioned in section 4.3, it is possible to consider incomes of other individuals in the household, if evidence can be provided that this income will be available to make the repayments. Where another

[23] CONC 5.2A.18 G (3)

person's income is considered in the assessment, account should also be taken of that person's non-discretionary expenditure.

> **A lender should consider:**
>
> If it's applicable to use household expenditure in the expenditure calculation.

5.4 Expenditure weighting

As mentioned in Section 5.1 and 5.2, the household composition will impact the individual's expenditure amount.

When using Open Banking, Bank Statements and CRA data, the expenditure amounts are specific to the individual, so these data do not need to consider household composition. However, when using statistical data, the data is at an estimated household level therefore, the lender may wish to consider capturing household level composition[24] at application and using this information to apply a weighting to the estimated expenditure amount.

For instance, if at application, 2 adults are stated as living in the household then the lender may wish to weight non-discretionary other payments by 50%, based on the assumption the individual will only pay for 50% of the food.

> **A lender should consider:**
>
> The individual's household composition at application to assess whether to apply weightings to the statistical data household level expenditure amounts.

5.5 Expenditure history

It is good practice to assess a minimum of 3 months' transactional information.

The lender may wish to categorise payments, where possible, across 12 months and then take a more recent period to calculate an average expenditure, to use in the affordability calculation.

[24] Household composition = number of adults and number of dependants.

Where there is evidence of gambling it would be prudent to review the expenditure amounts across a longer timeframe to ensure a complete view of the customers gambling habits. For instance, a customer may have excessive but irregular gambling payments that may not be picked up over a 3-month period.

Based on the lender's risk appetite and constraints, where the choice is available, the lender should select the number of months of banking history they are comfortable to use to make an expenditure assessment. It is good practice to consider the same number of historic months as that used to derive the income.

A lender should consider:

When using Open Banking or Bank Statements, the number of historic months' worth of transactional data to assess to:

Categorise expenditure items.

Use as part of the affordability calculation.

The number of months used as part of the income calculation when calculating expenditure.

5.6 Minimum expenditure buffer

If the lender chooses to include discretionary expenditure in the affordability calculation, then it is good practice to impose a floor on the minimum monthly discretionary expenditure amount - for example, £100, to account for unforeseen and unavoidable discretionary expenditures.

A lender should consider:

Whether to include discretionary expenditure in the affordability calculation.

Whether to include a minimum buffer and what this value should take.

5.7 Changes to expenditure

The lender must consider any foreseeable increases in expenditure[25] over the course of the agreement. Not taking this into account could lead to an overstated affordability of the customer. On the contrary,

[25] CONC 5.2AR (3)

decreases in the customer's future expenditure[26] may be considered but evidence should be provided to show this decrease will happen during the agreement.

For instance, an individual may currently spend £100 on fuel per month. However, if fuel prices were expected increase by 10% in the next 12 months, due to inflationary pressure, it would be conservative to factor £110 per month (£100 x 10%= £110) as the expenditure amount for fuel. Alternatively, an individual may state that they are expecting to travel twice as much each month due to job expectations, in which case £200 per month (£100 x 2) should be captured in the expenditure calculation for fuel costs.

The prudent approach is to consider possible increases in expenditure only, and not factor in any possible decreases in expenditure.

Lenders must also consider any changes to expenditure that their own lending decision will have on the borrower concerned. For example, credit unions that insist on borrowers saving alongside repaying a loan must factor that increased expenditure into their affordability assessment. Failure to do so may lead to upheld FOS complaints (see FOS complaint DRN-3828647[27].

A lender must:

Include foreseen increases in expenditure during the term of the agreement in the expenditure calculation.

A lender should consider:

The option to include foreseen decreases in expenditure over the duration of the agreement.

5.8 Expenditure tolerances

As with income verification it is good practice to verify the stated expenditure against sourced or estimated expenditure amounts. It may, however, be excessive to check against all sets of expenditure. For instance, Non-Discretionary Other Payments such as food and Discretionary payments such as restaurants and hotel stays can vary month on month and may be difficult for the individual to assign a value to. Credit commitments and contractual payments, however, can be tested against tolerances to ensure the correct information is being provided. For instance, if the credit commitments stated are 90%

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[26] CONC 5.2AR (5)
[27] https://www.financial-ombudsman.org.uk/decision/DRN-3828647.pdf

of the credit commitments calculated or estimated, it signals an understated expenditure. In scenarios like this is good practice to send this case to a more experienced person for further review.

If the expenditure values cannot be verified then the lender may consider using the higher of the stated expenditure vs the derived expenditure or rejecting the individual.

A lender should consider:

The tolerance levels to apply when comparing the credit commitment and contractual repayment expenditure vs the derived expenditure values.

The use of tolerances when using statistically estimated data.

The treatment of the individual when the key expenditure items cannot be verified:

Reject the individual

Use the highest expenditure value

5.9 Expenditure summary

Open banking is the most comprehensive data source for calculating the expenditure for use in the affordability calculation. Open banking should be used be the lender if possible.

Open banking allows the lender to choose up to 12 months' worth of transaction data to derive the individual's monthly expenditure. Open banking as a data source for expenditure has the advantage that it provides categorised expenditure amounts which make it easy for the lender to assess an overall level of expenditure by Non-Discretionary expenditure types, Credit Commitments, Contractual Payments, Other Payments, and Discretionary expenditure.

Given it is possible to derive the expenditure amount it allows the lender to apply the following, depending on the lender's risk appetite:

- A minimum discretionary expenditure amount
- Foreseen changes to the expenditure over the course of the agreement.

Open banking allows the lender sight of excessive gambling payments which may justify referring the application to a more experienced person for a more detailed review.

If the individual's expenditure cannot be derived and/or it is not possible to verify the stated credit commitments and contractual repayments using open banking due to lack of consent or lack of data, then the next step would be for the lender to source bank statements, which provide a similar type of data.

Bank Statements can be used in isolation or alongside open banking (to infill where open banking has limitations), to derive and verify the expenditure of the individual.

A lender can review 1 or more months' worth of bank statements. The information provided via bank statements is not categorised which makes it a more laborious and time-consuming to derive the final expenditure amount by category. This is a disadvantage of using bank statements instead of open banking to derive the individual's expenditure.

As per Open Banking, the lender can derive the expenditure amounts by category, albeit it is a more manual process than Open Banking. Having expenditure at category level allows the lender to apply a minimum discretionary expenditure amount and apply foreseen changes to specific expenditure types.

Bank statements allow the lender sight of excessive gambling payments which may justify referring the application to a more experienced person for a more detailed review.

If the individual's expenditure cannot be derived and/or verified using either Open Banking or Bank statements due to lack of consent or lack of data, then the lender may wish to use CRA data.

CRAs can provide a view on the individual's Non-Discretionary Credit Commitments and some types of Contractual Repayments across a 12-month historic view. This allows the lender to apply foreseen changes to these expenditure amounts and verify the stated payments against tolerances determined by the lender.

Given the limitations of the data, Non-Discretionary Other Payments, some Non-Discretionary Contractual Payments, such as rental payments, and Discretionary Payment amounts are not available through the CRA and would need to be sourced from other statistical data such as ONS.

Given the CRA cannot provide Discretionary expenditure amounts, the application of the minimum expenditure buffer cannot be applied when using CRA data.

If the individual's expenditure cannot be derived and/or verified using either Open Banking or Bank statements due to lack of consent or lack of data, CRA data can be used. However, CRA data cannot provide a full view of the individual's expenditure and a lender may wish to use Statistical data in infill any gaps.

Statistical Data (ONS for instance) can provide annual household average information. Information on Other Payments and Discretionary Payment amounts are available and can be used alongside CRA data when Open banking or Bank statements are not available.

Given the information is at average estimated household level, it would not be applicable to apply foreseen changes to expenditure and a minimum expenditure buffer. However, if there is a difference between the stated and estimated expenditure items it would be prudent to take the highest expenditure.

Payslips can only be used to validate income and do not provide any expenditure information.

The justification for using either both or 1 of the applicants' expenditures.

Where evidence of excessive gambling exists:

Refer to a more experienced person to investigate the individual's circumstances further

Consider how to refer the borrower for alternative support eg Gambling eg https://www.ncpgambling.org/help-treatment/national-helpline-1-800-522-4700/.

The individual's household composition at application to assess whether to apply weightings to the statistical data household level expenditure amounts.

When using Open Banking or Bank Statements, the number of historic months' worth of transactional data to assess to:

Categorise expenditure items.

Use as part of the affordability calculation.

The number of months of historic data used to calculate expenditure.

Whether to include discretionary expenditure in the affordability calculation.

Whether to include a minimum buffer and what this value should take.

The option to include foreseen decreases in expenditure over the duration of the agreement.

The tolerance levels to apply when comparing the credit commitment and contractual repayment expenditure vs the derived expenditure values.

The use of tolerances when using statistically estimated data.

6 Stress testing

The FCA CONC handbook require lenders to consider the likely changes to the customer's situation throughout the duration of their credit agreement. The guidance to the lender is to consider future financial commitments and future changes to the individual's circumstances. However, it is not prescriptive and there is no stated guidance or rules relating to stress testing.

Stress testing provides multiple benefits. It allows the lender to get a better understanding of the affordability risk to the individual if there are unexpected changes to their disposable income. It also provides valuable insight into the portfolio of customers and which pockets of customers may be prone to difficulties in meeting the future repayments.

It is at the lender's discretion whether they carry out stress testing and to what level this influences the lending decision. However it is a particular important consideration in the current cost of living crisis, as vulnerable customers are feeling the greatest impact, as called out in the FCA's "Dear CFO" letter in June 2022.

6.1 Income stress testing

As covered in Section 4.9, anticipated decreases to the individual's income should be accounted for if the changes are due to occur throughout the duration of the agreement.

In worsening economic circumstances, there is a higher likelihood that an individual will experience unemployment as opposed to reductions in the form of pay cuts. Unemployment is not an event that would be captured as part of stress testing as it would render the affordability calculation futile. In addition, in worsening economic circumstances, alternative income streams such as savings and benefits are unlikely to increase but they are also unlikely to reduce either. Therefore, applying stress testing to income amounts may not be applicable, but this will depend on the lenders risk appetite.

A lender should consider:

If it is appropriate to stress the income amount.

What level of stress testing the lender would want to consider for the income calculation.

If the stress will applied differ by income stream

6.2 Expenditure stress testing

As covered in Section 5.6, anticipated increases to the individual's expenditure should be accounted for if the changes are due to occur throughout the duration of the agreement. Expenditure stress testing can be carried out to ensure the individual can continue to make the required repayments over the course of the agreement, even if changes in the economic outlook mean the individual's expenditure increases from application.

All 3 categories of non-discretionary expenditure are susceptible to increases as well as decreases, however, it's the increases in these expenditure items that are concerning to a lender as these have an adverse impact on the individual being able to make the repayments by the due date.

For example:

- **Credit Commitments** can be subject to interest rate changes: Interest rate increases can occur when the individual's mortgage moves from fixed to variable.
- **Contractual payments** can be subject to price hikes: Fuel and gas prices can fluctuate and see large increases.
- **Other repayments** can be subject to increases due to factors such as inflationary pressures: Food prices can increase due to inflation and supply problems.

Discretionary payments are considered expenses that could be reduced under financial strain and as suggested in Section 5.6 a minimum discretionary payment amount can be set. These factors may negate any requirement to apply stresses to these payments.

A lender should consider:

If there is capacity and willingness to carry out stress testing.

What level of stress testing the lender would want to consider and to which expenditure items.

If the discretionary payment minimum negates the requirement for stress testing on this expenditure amount.

A lender should consider:

If there is capacity and willingness to carry out stress testing on income and/or expenditure.

What level of stress testing the lender would want to consider for income and expenditure.

Will the stress differ by income stream.

Which expenditure items to apply the stress testing:

Does the discretionary payment minimum negate the requirement for stress testing on this expenditure amount.

7 Affordability

7.1 Affordability calculation

The following details the disposable income calculation, that shows the individual's income left over each month after monthly expenditure (including monthly discretionary expenditure with minimum expenditure buffer) and stress factors are included:

Monthly Affordability Calculation =

(Verified Net Monthly Income + Income Stress Factor)

– [(Monthly Credit Commitments + Monthly Contractual Payments + Monthly Other Payments + min (Monthly Discretionary Expenditure, Minimum Expenditure)) + Expenditure Stress Factor]

There are situations where the full affordability checks are either not appropriate or cannot be carried out in full:

- Income cannot be verified.
- Expenditure components cannot be verified.
- Warning sign found – such as excessive gambling expenditure.
- Evidence or knowledge that the individual is in financial distress on applying for the credit agreement.
- Heavy reliance on estimated average data such as ONS for verification.

In these cases, good practice is to refer these cases to a more experienced person, where they can engage directly with the customer to seek the relevant information to assess their affordability. It remains important in these cases that the information captured, and steps taken as part of the process, are fully evidenced, and documented. This should be to a standard whereby an independent third party could understand and replicate the process that was followed in coming to that decision.

7.2 Minimum affordability buffer

A lender may wish to consider a minimum affordability threshold permitted before lending. For instance, the lender may wish to apply a £100 minimum disposable income amount. If the individual's monthly affordability calculation drops below this amount, then the lender may decide to refer the individual to the head of credit for review or reject the application.

A lender should consider:

Whether to require a minimum disposable income amount

Treatment of applications where the disposable income is less than the buffer

7.3 Debt-to-income ratio cap

A lender may wish to consider a maximum debt to income ratio (i.e., current net monthly income / monthly debt payments including new loan repayment).

If the debt-to-income ratio is exceeded, then the lender may wish to refer the individual to a more experienced person to get a detailed understanding of the circumstances.

7.4 Maximum exposure amount

The Monthly Affordability calculation can then be used when considering a loan or credit limit size, the maximum amount can be based on the following:

Maximum Exposure Amount =
Monthly Affordability Calculation * Loan Term
Where Monthly Affordability Calculation must be greater than the minimum affordability threshold.

If the customer wishes to borrow more than the calculated Maximum Exposure Amount, then the lender could consider offering a longer-term loan, if this is within their risk appetite and product offering and meets the customer's financial objectives. For example, if a customer cannot afford a loan of 24-month term but could afford to borrow the same amount over 36 months then the lender may wish to offer them the longer-term loan. If the lender's policy is to only offer terms up to 24 months, then in this case the customer would likely be declined.

Longer term lending can carry a higher risk than shorter-term, as there is more time for something to change in the customer's circumstances and there is a higher cost associated to the loan overall, so the lender would need to be satisfied the customer is creditworthy for this longer period and this therefore remains a good outcome for the customer, also considering any likely income and expenditure changes over this longer timeframe.

8 Monitoring

Lenders should have monitoring in place to assess the key affordability metrics of their customers, covering both the customers information at application and their on-book performance.

Examples of key metrics lenders may wish to consider are:

- the number of customers accepted/declined
- number of joint applications
- average incomes
- average disposable income
- and linking the above metrics to the number of subsequent missed payments, to continuously review and refine the strategies

Future documents in this series will cover strategy monitoring and MI reporting in general.

9 Governance

As part of good governance, a lender's Affordability lending policy should be reviewed on a periodic basis and any assumptions and tolerances updated as necessary.

A future document within this series will cover the topic of Governance in more detail.

10 Document summary and check list

Each lender will have a slightly different approach on how to document their affordability lending policy. However, the important thing is that the document considers all aspects of the affordability calculation.

The following table provides a checklist that a lender should follow to ensure a comprehensive affordability lending policy document. A lender should look to evidence that each section has been considered and provide justification for the choices made.

Section	Checklist
Data Sources	• How and when will each data source be used: – Open banking data – Bank statements – Payslips – Credit Reference Agency data – Statistical data e.g., ONS
Income Type	• How will each income type be used: – Individual Income – Joint Income – Household Income • How will the income calculation treat the following income streams: – Salary – Savings and Other Assets

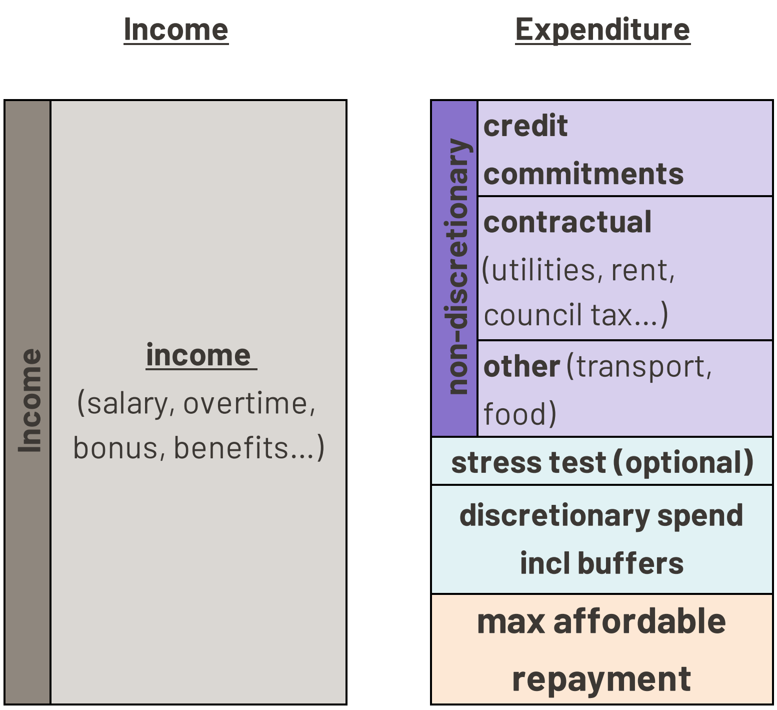
	– Bonuses – Overtime – Second Job – Benefits • How will irregular incomes be treated?
Expenditure Type	• How will each expenditure type be used: – Individual Expenditure – Joint Expenditure – Household Income • How will expenditure items be categorised (Discretionary, Non-discretionary Credit Commitments etc)? • How will Discretionary expenditure be treated in the affordability calculation? • If statistical data is used, how will household estimated? expenditures be weighted to account for the household composition? • How will gambling expenditures be treated?
Data History	• How many months' worth of historic income and expenditure data will be used: – For categorising income and expenditure? – For calculating income and expenditure for use in the affordability calculation?
Buffers	• Will a minimum buffer be applied to the discretionary expenditure amount and what value will this take? • Will a minimum income be required at application? • Will a minimum disposable income be required?
Changes to Circumstances	• How will anticipated increases in expenditure be factored into the expenditure calculation? • How will anticipated decreases in income be factored into the income calculation?

	• How will anticipated decreases in expenditure be treated? • How will anticipated increases in income be treated?
Tolerances	• Will tolerances be applied when comparing the stated to the derived income and expenditure: – What tolerances will be used? – Will different tolerances be applied to different income streams? – Will different tolerances be applied to different expenditure categories? • When will the stated income/expenditure be used over the derived income/expenditure and vice-versa.
Stress Testing	• Will stress testing be performed on the income/expenditure amounts: – Which income/expenditure types will be stressed. – How will each income/expenditure type be stressed (%/£ uplift) – How much will each income/expenditure type be stressed (5%/10%/+£100 etc)
Agreement Type	• What type of lending will be offered: – Credit or loan – Weekly/fortnightly/monthly – Term – Exposure amount • How will the type of lending impact the calculations/decisions made?
Treatment of Application	• How will the application be treated if certain conditions such as minimum income and tolerances etc not met? – Refer to a more experienced person – Decline the individual • How will the application be treated if overall affordability criteria are not met or it is not possible to carry out the full affordability assessment? – Refer to a more experienced person

	– Decline the individual – Offer an alternative such as a longer term, lower amount offered?
Implementation	• How is the affordability calculation implemented – Which system?
Monitoring	• Details of any MI or reporting of affordability
Governance	• What governance policies will be in place: – How often is the policy reviewed? – How often are the parameters/buffers/stress rates reviewed? – What is the process for approving any changes? • Link to Risk Appetite statement
Version Control	• Include a version control log of all updates and revisions to the policy document.

11 Worked examples introduction

The affordability assessment is used to determine the maximum affordable monthly repayment amount, after a customer's expenditure is deducted from their income, illustrated by this diagram:

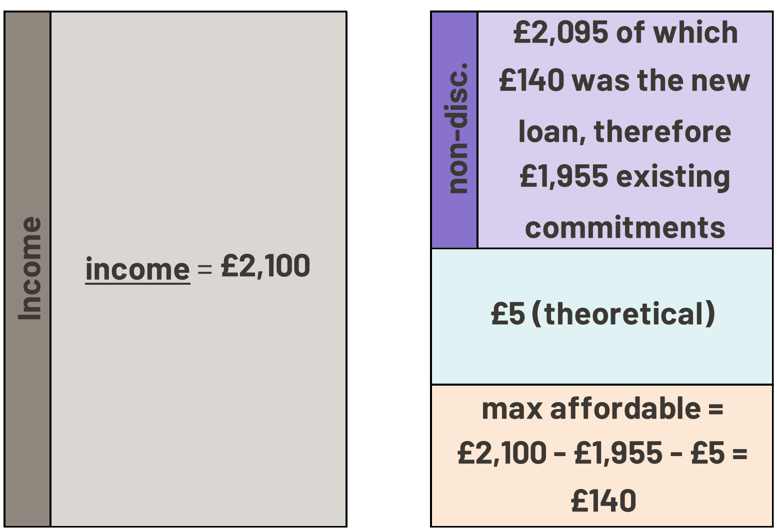


The "max affordable repayment" is the amount that the customer has left over, after deducting their non-discretionary commitments, and allowing for their discretionary spend.

11.1 Worked example – upheld complaint

As a simple example, taking the figures from the FOS case where Miss G complained that a credit union had irresponsibly given her a loan costing £140 per month (See <u>Appendix C</u> for more details of the case) we have:

<u>Income</u> **<u>Expenditure</u>**



In the case of Miss G, the only way she could afford the new loan, as well as her existing commitments, is to assume she has only £5 disposable income per month. At this stage, the credit union could see that she would not be able to afford to repay the loan without struggling.

In addition, the Ombudsman noted that the new loan offered by Boom! did not cover all of Miss G's outstanding unsecured debt of approximately £3,000. The CU could have considered other options such as fully covering Miss G's existing debt with the consolidation loan, or lending over a longer period which would have meant a smaller monthly instalment amount being due.

The FOS upheld Miss G's complaint and directed the credit union to put things right by removing all interest, fees and charges applied to the loan.

11.2 Worked examples - general

The next three sections provide detailed examples of an affordability assessment for an Unsecured Loan Application. Each section describes the checks that should be made, and how to include buffers, tolerances, and stress testing, before performing the affordability calculation to determine the maximum monthly repayment amount that the customer can afford.

In each example, the same loan details are used. The customer has applied to a lender that offers loans of between £1,000 and £5,000 over terms of between 6 and 24 months. APRs varying between 14.99 and 49.99% depending on the size and the term of the loan.

The individual has applied to borrow £1,500 to be repaid over 12 months. The terms under which the company is willing to lend is as follows:

APR: **24.99%**

Monthly repayment: **£140.76**

12 Worked example 1

Example 1: Provides an example affordability assessment for an application where Open Banking, Bank Statements and Payslips are available.

12.1 Data sources

Open Banking – The lender requires the individual to provide access to open banking as part of the application. Otherwise, the individual is rejected.

12.2 Individual income and expenditure type

The individual has stated the following at application:

- Net Monthly Income (stated) = £1,750
- Non-Discretionary Monthly Credit Commitments = £700
- Non-Discretionary Monthly Contractual Repayments = £100

The Net Monthly Income stated by the applicant is made up of the following:

- Base Salary: £1,400
- Overtime: £250
- Second Job: £0
- Bonuses: £100
- **Total: £1,750**

However, the lender's current policy is that overtime should not be included in the Net Monthly Income calculation, as they feel that it is too volatile/uncertain to include in their 12-month loan repayment calculation. Therefore, for the purpose of calculating affordability, the income at this stage is taken to be **£1,500** (£1,750 less £250 overtime income).

The Non-Discretionary Monthly Credit Commitments are made up of the following:

- Credit Card Payments: £100
- Mortgage Payment: £600

- **Total** **£700**

The Non-Discretionary Monthly Contractual Payments are made up of the following:

- Utility Payments: £30
- **Total** **£30**

Non-Discretionary Monthly Other Payments and Discretionary Monthly Payments are not requested at application as they are deemed to be difficult to consistently quantify over a set period.

Savings and Other Assets

The individual has not mentioned that savings or other assets will be used to pay or to part pay the repayment amount.

Benefits

The individual has made the lender aware that they also receive £100 in benefits, paid into a separate account not part of the open banking submission. The lender verifies this via bank statements that the applicant has provided.

The lender considers benefits as valid income. Therefore, the total income, as stated by the applicant, that will be considered in the affordability calculation is **£1,600** (£1,500 + £100).

12.3 Joint and household income and expenditure

If this was a joint application, then the joint income and expenditure would be considered in the calculation. However, this is an individual application, so this section is not applicable.

The lender's policy is not to include household income, therefore other individuals living in the household are not included in the income and expenditure calculations.

12.4 Data history

The individual has given the lender consent to assess all the relevant current account via open banking over the last 12 months to categorise the income and expenditure amounts. The lender's policy is to use the most recent 3 months to derive the average monthly income and expenditure values.

12.5 Determining the income and expenditure values to use in the affordability calculation

The lender then uses the information that has been collected about income and expenditure from different sources, to derive the final values to be used in the affordability calculation. The general principle throughout is that where two or more values are available, then the most conservative value is used. For example, the income stated by the applicant is £1,600, but the value calculated from bank statements is £1,500. Therefore £1,500 is chosen. This is shown in the following table.

Type of Payment	**Amount Stated (£)**	**Amount Derived (£)**	**Check**	**Amount Used (£)**
Net Monthly Income (Stated by the applicant)	£1,600	n/a	=Amount Stated/Amount Derived =£1,600/£1,500 = 107% *Income Tolerance = 90% to 110%* 90% < 107% < 110% *Min Income Buffer = £1400* £1,600 and £1,500>£1,400 **Requirements are met**	£1,500 *(Lowest of the 2 income values)*
Net Monthly Income (Open Banking/Bank Statements)	n/a	£1,500		
Non-Discretionary Monthly Credit Commitments:				
Credit Card Payments	£100	£100	=Amount Stated/Amount Derived =£100/£100 =100% *Expenditure Tolerance= 90% to 110%* 90% < 100% < 110% **Requirements are met**	£700
Mortgage Payment	£600	£600	=Amount Stated/Amount Derived =£600/£600 = 100% *Expenditure Tolerance= 90% to 110%* 90% < 100% < 110% **Requirements are met**	
Non-Discretionary Monthly Contractual Repayments:				
Utility Payments	£30	£30	=Amount Stated/Amount Derived =£30/£30 = 100% *Expenditure Tolerance= 90% to 110%* 90% < 100% < 110% **Requirements are met**	£30
Non-Discretionary Monthly Other Payments				
Food	n/a	£100	*Non-Discretionary Other Payments are not*	£100

Type of Payment	Amount Stated (£)	Amount Derived (£)	Check	Amount Used (£)
			requested **Requirements are met**	
Monthly Discretionary Expenditure				
Restaurants and Hotels	n/a	£50	Total Monthly Discretionary Expenditure = £70 *Min Expenditure Buffer=£100* £70<£100 **Requirements are not met**	£100 *(Requirements are not met so set total monthly discretionary expenditure to £100)*
Recreation and Clothing	n/a	£20		

12.6 Buffers

The lender's risk appetite states a minimum net monthly income amount of £1,400 is required.

- The minimum (derived) income amount of £1,500 is above £1,400, therefore, this threshold is met. If this threshold had not been met the individual's application would be rejected.

The lender's risk appetite states a minimum monthly discretionary expenditure amount of £100.

- The check finds the monthly discretionary expenditure amount is £70 which is below the £100 threshold. The minimum payment buffer will be enforced, and the discretionary expenditure amount will be set to £100 in the affordability calculation.

The lender's risk appetite states a minimum £200 disposable income. This will be assessed following stress testing.

12.7 Changes to income and expenditure

There were no expected changes to the individual's income or expenditure over the course of the agreement so there are no changes to the income or expenditures amounts.

If there were foreseen *decreases in income* or *increases in expenditure*, then these would have been subtracted/added respectively.

Foreseen *increases in income* or *decreases in expenditure* would not have been included to ensure a prudent approach.

12.8 Tolerances

Income

The net monthly income stated is checked against the net monthly income calculated from Open Banking submissions plus the benefit amount provided separately, evidenced via Bank Statements. The lender has set a 90-110% tolerance check. This applied to income and all expenditure categories (tolerances do not change based on income or expenditure type).

- The check is 107% which is within tolerance
- The lower of the 2 income values (£1,500 derived income vs £1,600 stated income) will be used for the most prudent affordability check: £1,500

Expenditure

The Non-Discretionary Credit Commitments and Contractual Repayments stated are checked against the calculated values from the Open Banking submission.

- The check is 100% which is within tolerance

Initial affordability calculation

If any of these checks had been outside of tolerance, then the individual should have been requested to provide further evidence such as bank statements. If this could not be provided, then the individuals application would be rejected.

The calculated income and expenditure amounts are then used to calculate the customer's affordability as shown in the table below:

Component of Affordability	Amount (£)	Affordability Calculation (£)
Net Monthly Income	1,500	=1,500 – 700 – 30 – 100 – 100 =£570
Non-Discretionary Monthly Credit Commitments	700	
Non-Discretionary Monthly Contractual Repayments	30	
Non-Discretionary Other Payments	100	
Monthly Discretionary Expenditure with buffer included	100	

12.9 Stress testing

Stress testing has been carried out to understand how susceptible the individual is to changes in their circumstances.

An income stress has not been applied as the lender does not believe the income will reduce and feel it is overly conservative to apply an income stress (as per comments made in section 6.2).

The lender applies a 20% stress to the expenditure amounts. As suggested in section 6.2, given the discretionary expenditure amount already has a buffer of £100 applied, this expenditure amount remains constant at all stress levels.

- The stress testing shows that the individual has £404 monthly affordability at the 20% stress level.

Type of Payment	Amount (£)	Stress (+/- 20%)
Net Monthly Income	1,500	1,500
Non-Discretionary Monthly Credit Commitments	700	840
Non-Discretionary Monthly Contractual Repayments	30	36
Non-Discretionary Monthly Other Payments	100	120
Monthly Discretionary Expenditure with buffer included	100	100
Net Monthly Affordability	=£570	=£404

The lender has specified a minimum affordability buffer of £200.

- Across all stress testing applied, the minimum affordability buffer criteria are met.

Type of Payment	Amount (£)	Stress (+/- 20%)
Net Monthly Affordability	570	404
Minimum Affordability Buffer	200	200
Affordability Criteria	=£570>£200 Criteria Met	=£404>£200 Criteria Met

12.10 Agreement type

The maximum 12-month exposure is as follows:

	No Stress	Stress (+/- 20%)
Net Monthly Affordability	=£570	=£404
Maximum Exposure	=£570 x 12 = £6,840	£4,848

As detailed above, the lender's policy is to apply a stress of 20% to align to their current risk appetite. Therefore, the individual can afford to borrow (initial advance plus interest and other charges):

- £4,848 maximum per annum
- £404 maximum per month

Given that the individual has requested a loan with a monthly repayment of £140.76, the loan is deemed affordable. Therefore, they will be eligible for a loan, if they also pass the lender's customer verification, fraud checks and credit risk assessment (Future elements of the Lending Policy guide will provide further details of these elements).

12.11 Treatment of application

This is covered in each individual step of the process.

13 Worked example 2

Example 2: Provides an example affordability assessment for an application where the individual has an irregular income stream.

13.1 Data sources

Open Banking – the lender requires the individual to provide access to open banking as part of the application. Otherwise, the individual is rejected.

13.2 Individual income and expenditure type

The individual is self-employed; and their income is irregular and can vary anywhere between £800 and £3,000 a month. It can also fall to £0 if the individual does not work.

- Net Monthly Income (stated) = £0 - £3,000 depending on the month
- Non-Discretionary Monthly Credit Commitments = £500
- Non-Discretionary Monthly Contractual Repayments = £100

The Net Monthly Income stated by the applicant is made up of the following:

- Base Salary: £0 – £3,000 (range)
- Overtime: £0
- Second Job: £0
- Bonuses: £0
- Total **£0 - £3,000 (range)**

The Non-Discretionary Monthly Credit Commitments are made up of the following:

- Credit Card Payments: £100
- Loan Payments: £400
- **Total** **£500**

The Non-Discretionary Monthly Contractual Payments are made up of the following:

- Utility Payment: £100
- **Total** **£100**

Non-Discretionary Monthly Other Payments and Discretionary Monthly Payments are not requested at application as they are deemed to be difficult to consistently quantify over a set period.

Savings and Other Assets

The individual has not mentioned that savings or other assets will be used to pay or to part pay the repayment amount.

Benefits

The individual does not receive any benefits.

13.3 Joint income and expenditure

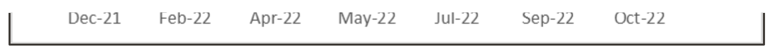
If this was a joint application, then the joint income and expenditure would be considered in the calculation. However, this is an individual application, so this section is not applicable.

Individuals living in the household but not part of the application, i.e. not a joint applicant, are not included in the income and expenditure calculations.

13.4 Data history

The income was checked against open banking and open banking returned the following derived income amounts across a 12-month period.

Month	Net Monthly Amount
Jan 22	£800
Feb 22	£1,560
Mar 22	£2,890
Apr 22	£1,730
May 22	£3,000
Jun 22	£1,850
Jul 22	£0
Aug 22	£1,900
Sep 22	£2,720
Oct 22	£0
Nov 22	£2,750
Dec 22	£0



This evidences irregular income amounts over the course of 12 months. The range of income is £0 in some months to £3,000 in others, with an average monthly income of £1,600, and this can all be considered when assessing affordability. This is the same average income as for Example 1. In circumstance likes these, the standard affordability calculation is not suitable on its own, therefore the additional steps are not applicable as this application requires more bespoke treatment – see Treatment of application section below.

13.5 Buffers

n/a

13.6 Change to income and expenditure

n/a

13.7 Tolerances

n/a

13.8 Stress testing

n/a

13.9 Agreement type

n/a

13.10 Treatment of application

The individual has irregular income that has the potential to fall to £0. Therefore, while the overall income throughout the year is the same as for Example 1, there is a risk that the customer may not be able to keep up repayments in those months where the income is below average.

Instead, it is appropriate to refer to a more experienced person who can engage with the individual to get a more detailed picture of their circumstances. In this case, this would include understanding the expected future income over the course of the 12 months of the agreement being applied for and the customer's ability to make repayments in those months where their income is below average. It may be appropriate to consider what other help the borrower can be offered in that discussion – for example checking whether they are entitled to benefits they are not claiming using a checker – Fair4All Finance is providing funding to lenders to adopt these.

14 Worked example 3

Example 3: Provides an example affordability assessment for an application where Open Banking and Bank Statements are not available.

14.1 Data sources

The individual does not have access to open banking and is not able to provide the relevant bank statements. They have offered to provide payslips as a proof of income.

Payslips and a CRA check will be used the verify the income.

CRA and supplementary ONS data will be used to verify/calculate the expenditure items.

14.2 Individual income and expenditure

The individual has stated the following at application:

- Net Monthly Income (stated) = £2,000
- Non-Discretionary Monthly Credit Commitments = £500
- Non-Discretionary Monthly Contractual Repayments = £600

The Net Monthly Income stated by the applicant is made up of the following:

- Base Salary: £1,500
- Overtime: £0
- Second Job: £500
- Bonuses: £0
- **Total** **£2,000**

The Non-Discretionary Monthly Credit Commitments are made up of the following:

- Credit Card Payments: £100
- Loan Payments: £400
- **Total** **£500**

The Non-Discretionary Monthly Contractual Payments are made up of the following:

- Utility Payment: £100
- Council Tax: £100
- Rent: £400
- **Total** **£600**

The lender will accept incomes from secondary jobs if the income from these sources is not volatile over time.

Non-Discretionary Monthly Other Payments and Discretionary Monthly Payments are not requested at application as they are deemed to be difficult to consistently quantify over a set period.

Savings and Other Assets

The individual has not mentioned that savings or other assets will be used to pay or to part pay the repayment amount.

Benefits

The individual does not claim any benefits.

14.3 Joint income and expenditure

If this was a joint application, then the joint income and expenditure would also be considered for the calculation. However, this is an individual application, so this section is not applicable.

Individuals living in the household but not part of the application, i.e. not a joint applicant, are not included in the income and expenditure calculations.

14.4 Data history

To ensure that the secondary income is consistent over time and not an ad hoc income stream, the lender has requested 6 months' worth of payslips.

From these payslips the following is identified:

Month		Net Monthly Amount – Base Salary Payslip	Net Monthly Amount – Secondary Salary Payslip
Jul 22		£1,500	£480
Aug 22		£1,500	£480
Sep 22		£1,500	£480
Oct 22		£1,500	£480
Nov 22		£1,500	£480
Dec 22		£1,500	£480

The income declared during the application differs by £20 from what is recorded on the payslips, but this is a relatively small discrepancy (as calculated below). The CRA check, which checks against a 12-month outcome the CRA provides a "Green" RAG status, which is evidence that the income is verified against the income data held on the bureau; i.e. is very close to what the applicant has stated. Consequently, the lowest confirmed value is used to calculate the total income; i.e. £1,980 (£1,500 + £480).

14.5 Determining the income and expenditure values to use in the affordability calculation

The lender then uses the information that has been collected about income and expenditure from different sources, to derive the final values to be used in the affordability calculation, as detailed in the following two tables.

Type of Payment	Amount Stated (£)	Amount Derived (£)	Check	Amount Used (£)
Net Monthly Income (Base Salary Stated)	1,500	n/a	=Amount Stated/Amount Derived =1500/1500 =100% *Income Tolerance = 90% to 110%* 90% < 100% < 110% *Min Income Buffer = n/a*	
Net Monthly Income (Base Salary Payslip)	n/a	1,500		

Type of Payment	Amount Stated (£)	Amount Derived (£)	Check	Amount Used (£)
			Requirements are met	=1500 + 480 =1980
Net Monthly Income (Secondary Job Stated)	500	n/a	=Amount Stated/Amount Derived =500/480 =104% *Income Tolerance = 90% to 110%* 90% < 104% < 110% *Min Income Buffer = n/a* **Requirements are met**	
Net Monthly Income (Secondary Job Payslip)	n/a	480		
Net Monthly Income (CRA)	2,000	GREEN	Green RAG setting further verifies the income. **Requirements are met**	

Given that open banking data is not available, verification of the customer's expenditure information is based on values supplied by the CRA as part of a credit search or based on ONS estimates of average spend. In addition, where details of certain expenditures such as food and recreation have not been supplied by the customer, ONS estimates have also been used.

Type of Payment	Amount Stated (£)	Amount Derived (£)	Check	Amount Used (£)
Non-Discretionary Monthly Credit Commitments:				
Credit Card Payments	100	100 (CRA)	=Amount Stated/Amount Derived =£100/£100 = 100% *Expenditure Tolerance= 90% to 110%* 90% < 100% < 110% **Requirements are met**	520 *(Take the CRA payment amounts for calculation)*
Loan Payment	400	420 (CRA)	=Amount Stated/Amount Derived =400/420 95% *Expenditure Tolerance= 90% to 110%* 90% < 95% < 110% **Requirements are met**	
Non-Discretionary Monthly Contractual Repayments:				
Utility Payments	100	110 (CRA)	=Amount Stated/Amount Derived =100/110 91% *Expenditure Tolerance= 90% to 110%* 90% < 91% < 110% **Requirements are not met**	110 (Higher of the two values)
Council Tax	100	150 (ONS)	=Amount Stated/Amount Derived =£100/£150 = 67% *Expenditure Tolerance= 90% to 110%* 90% > 67% **Requirements are not met**	REFER
Rent	400	450 (ONS)	=Amount Stated/Amount Derived =£400/£450 = 89% *Expenditure Tolerance= 90% to 110%* 90% > 89% **Requirements are not met**	REFER
Non-Discretionary Monthly Other Payments				
Food	n/a	100 (ONS)	*Non-Discretionary Other Payments are not requested* **Requirements are met**	100
Monthly Discretionary Expenditure				
Restaurants and Hotels	n/a	100 (ONS)	Total Monthly Discretionary Expenditure	120

Type of Payment	Amount Stated (£)	Amount Derived (£)	Check	Amount Used (£)
Recreation and Clothing	n/a	20 (ONS)	=£100 *Min Expenditure Buffer=100* £120>£100 **Requirements are met**	

14.6 Buffers

The lenders risk appetite does not state a minimum net monthly income.

- This check is not applicable.

The lender's risk appetite states a minimum monthly discretionary expenditure amount of £100.

- The check finds the monthly discretionary expenditure amount is £120 which is above the £100 threshold. So, no action is required.

The lender's risk appetite states a minimum £300 disposable income. This will be assessed following stress testing.

14.7 Changes to income and expenditure

There were no expected changes to the individual's income or expenditure over the course of the agreement so there are no changes to the income or expenditures amounts.

If there were foreseen decreases in income or increases in expenditure, then these would have been subtracted/added respectively.

Foreseen increases in income or decreases in expenditure would not have been included to ensure a prudent approach.

14.8 Tolerances

Income

The net monthly income stated is checked against the net monthly income calculated from the 2 payslips provided by the individual. One payslip contains evidence of the base salary and the other, evidence of the secondary job salary.

The lender has set a 90-110% tolerance check. This applies to income and all expenditure categories (tolerances do not change based on income or expenditure type).

- Base Salary: The check is 100% which is within tolerance.
- Secondary Job: The check is 104% which is within tolerance.
- The lower of the overall 2 income values (£1,980 derived income vs £2,000 stated income) will be used for the most prudent affordability check: £1,980.

Expenditure:

The Non-Discretionary Credit Commitments are checked against the data held by the CRA:

- Credit Payments: The check is 100% which is within tolerance.
- Loan Payments: The check is 95% which is within tolerance.
- The higher of the of the overall expenditure values (£520 derived vs £500 stated) will be used for the most prudent affordability check - £520

The Non-Discretionary Monthly Repayments are checked against either the CRA or ONS based on availability of data, as follows:

- Utility Payments: This data is available from the CRA so can be checked against this data source. The check is 91% which is within tolerance.
- Council Tax and Rent: This data is not available from the CRA so this needs to be checked against estimated household ONS data. The checks are 67% and 89% respectively which is outside of the lender's tolerance.

Verifying Council Tax and Rent against estimated data means there is a higher likelihood the expenditure is outside of tolerance. In circumstances like this it is appropriate to get a more detailed picture of the individual's circumstances, for example, asking them to provide a copy of their council tax bill and rental agreement.

14.9 Stress testing

n/a

14.10 Agreement type

n/a

14.11 Treatment of application

Refer the individual to a more experienced person.

15 Appendix

15.1 Appendix A: glossary of terms used in the affordability guide

Please see the full Glossary for a comprehensive list of Credit Risk Management terms.

Term	Description
Community Finance Lending	An informal term used to refer to lending to individuals where the primary goal is social benefit. This doesn't mean that providing a loan can't be profitable, but that the primary purpose of the loan is to benefit the customer and/or the wider community. Often this type of lending is low value (<£2,000) and short term (<24m) but this need not necessarily be the case.
Consumer Credit Source Book (CONC)	The Consumer Credit Source Book (CONC) is the FCA's specialist sourcebook for credit-related activities. It principally covers lenders' obligations regarding unsecured credit or secured against non-land-based assets (such as cars). For credit agreements secured on land, such as a residential mortgage, these are covered by the FCA's Mortgage and Home Finance: Conduct of Business Sourcebook (MCOB).
Credit Reference Agency (also known as a Credit Bureau)	An organisation, licensed under the Consumer Credit Act 1974, to hold information about individuals' repayment behaviour when using credit products such as mortgages, loans, and credit cards. Nearly all UK-based Lending institutions provide details of the balances and arrears status of their customer accounts to one or more of the UK credit reference agencies each month. When a new customer applies for a loan, a lender will purchase a copy of the customer's credit report from the CRA, which details the balances and arrears status of the customers current and previous loan agreements with other lenders. The 3 main credit reference agencies in the UK are Experian, Equifax, and TransUnion (formally CallCredit).
Credit Score	A credit score is a number which provides a holistic view of a customer's creditworthiness, based on several different features (characteristics). Typically, these features are a mixture of geo-demographics (e.g., age,

	occupation, residential status) and financial history (e.g., number of existing credit agreements, credit card utilisation, defaults, and court judgements). Credit Reference Agencies each provide their own score, and these will differ from each other. Individual lenders often develop their own Credit Score, which is tailored to their customer base.
Credit Unions sourcebook (CREDS)	The Credit Unions sourcebook is the FCA's specialist sourcebook for credit unions. Most credit union lending falls within the remit CREDS, but for regulated lending activities not covered by CREDS such as mortgage lending or high interest loans, then the regulations are defined by the relevant source book; i.e. CONC and MCOB for unsecured and lending secured on land (mortgages) respectively.
Financial Conduct Authority (FCA)	The FCA is the regulatory body that oversees consumer credit lending in the UK. The FCA is responsible for the Consumer Credit Source Book (CONC) and the credit unions Source Book (CREDS).
Financial Ombudsmen Service (FOS)	The Financial Ombudsman Service is a free and easy-to-use service that settles complaints between consumers and businesses that provide financial services. Usually, customers will be referred to FOS if they cannot find a satisfactory resolution to their issue via direct negotiation with their lender.
Know Your Customer (KYC)	The FCA requirement to "Know your Customer" primarily relates to confirming that the customer is who they say they are, and that they are someone that the company is allowed to do business with. This is to prevent fraud and other criminal activities, such as money laundering.
Open Banking	Open banking refers to customers who have given permission for lenders to review the transactions that occur in relation to their bank account(s). This enables the lender to verify the customer's income and expenditure patterns.
Stress Testing	For the purposes of calculating affordability, stress testing involves considering the affordability of loans under harsher, stressed, conditions. The goal is to ensure that the customer has some resilience to changing circumstances, and that any credit they obtain remains affordable if things change. Examples of stressing are adding future inflationary prices rises into expenditure, factoring in increased mortgage payments in response to rising interest rates, and discounting certain elements of income, such as bonus payments.

15.2 Appendix B: relevant legislation

Regulation	Description
Consumer Credit Source Book (CONC 5.2A)	The primary regulation for consumer credit firms, excluding lending secured on land (i.e., mortgages). CONC is managed and updated by the FCA and incorporates the FCA's interpretation of the Consumer Credit Act, plus additional FCA policies and principles relevant to retail credit providers. CONC 5.2A – Creditworthiness Assessment
Credit Unions sourcebook (CRED 7.1 Application, p**urpose,** and interpretation)	This chapter of the sourcebook seeks to protect the interests of credit unions' members in respect of lending. Principle 4 requires credit unions to maintain adequate financial resources. The rules and guidance in this chapter are in addition to the provisions of (in relation to Great Britain credit unions) section 11 and section 11E of the Credit Unions Act 1979 and (in relation to Northern Ireland credit unions) article 28 of the Credit Unions (Northern Ireland) order 1985.

15.3 Appendix C: Financial Ombudsman Office (FOS) complaints

Link to complaints below

DRN3591497	**The Complaint:** Ms O complains that London Mutual credit union Limited ("LMCU") irresponsibly granted her credit that she couldn't afford to repay. **Final Decision:** Upheld
DRN3828647	**The Complaint:** Miss G complains that West Sussex and Surrey credit union Limited trading as Boom! credit union irresponsibly lent to her, providing a consolidation loan that did not cover her existing unsecured lending balance. **Final Decision:** Upheld
DRN3745673	**The Complaint:** Miss M complains that London Community credit union Limited (LCCU) provided her a top up loan that was unaffordable and did assist her when she was in financial difficulties. **Final Decision:** Upheld
DRN6065774	**The Complaint:** Mr S has complained about two loans granted to him by 1st Stop Recoveries Limited ("1st Stop"). He said 1st Stop encouraged him to borrow more than he could afford, which resulted in him needing to borrow regularly to repay previous loans **Final Decision:** Upheld
DRN3602776	**The Complaint:** Mr E has complained that Hillingdon Credit Union Limited ("Hillingdon") provided him with unaffordable loans. He says it was irresponsible for him to have been provided with these loans. **Final Decision:** Upheld

FOS guidelines for businesses on unaffordable lending:

Unaffordable lending (financial-ombudsman.org.uk)

This link also gives details of the FOS's view of what constitutes "Reasonable and proportionate checks", included here for reference:

Reasonable and proportionate checks

There has never been a "set list" of checks that lenders needed to carry out. But given the relevant law and regulation, regulators' rules, guidance and standards, codes of practice, and what we consider to be good industry practice at the time we'd typically reach the view that a reasonable and proportionate check would usually need to be more thorough:

- the lower a customer's income (reflecting that it could be more difficult to make any loan repayments to a given loan amount from a lower level of income);
- the higher the amount due to be repaid (reflecting that it could be more difficult to meet a higher amount from a particular level of income);
- the longer the term of the loan (reflecting the fact that the total cost of the credit is likely to be greater and the customer is required to make payments for an extended period); and
- the greater the number and frequency of loans, and the longer the period during which a customer has been given loans (reflecting the risk that repeated refinancing may signal that the borrowing had become, or was becoming, unsustainable).

So, what all of this means is that a less detailed affordability assessment, without the need for verification, is far more likely to be fair, reasonable, and proportionate where the amount to be repaid is relatively small, the consumer's financial situation is stable, and they will be indebted for a relatively short period.

But, in circumstances where a customer's finances are likely to be less stable, they are being expected to repay a larger amount for a longer period. There are the other potential factors (such as the borrower losing any security provided, or a guarantee could be called on), it's far more likely that an affordability assessment will need to be more detailed and contain a greater degree of verification, for it to be fair, reasonable, and proportionate.

FOS guidelines for consumers on Unaffordable Lending:

Unaffordable lending (financial-ombudsman.org.uk)

15.4 Appendix D: data sources

Open Banking

Open Banking is a mechanism whereby an individual gives an organisation permission to view details of their current accounts electronically. This covers money paid into accounts such as salary, pensions, and benefits, as well as payments made from accounts such as utility bills, grocery shopping and cash withdrawals. In principle, this is the same type of information that a customer sees on their bank statements each month.

Customers can also give access to savings accounts, e-money accounts, and credit cards, in addition to their current accounts.

There are various providers of Open Banking in the UK, and the standards for open banking are set by the Open Banking Implementation Entity (OBIE). For further information, including a list of providers, see: About the OBIE – Open Banking

As of December 2020[28], 70% of the community finance sector were already using open banking.

The main benefits of open banking are:

- It supports know Your Customer (KYC) requirements, acting as a form of customer identity verification to enable you to confirm that the individual is who they say they are
- It enables lenders to automatically verify the details that an individual provides about their income and expenditure when they apply for credit. To put it another way, if a customer's open banking data is available then there is usually no requirement to ask a customer to provide separate bank statements or payslips as evidence
- It enables lenders to see transactions that might suggest that a borrower has a higher risk of getting into difficulty eg excess gambling
- It provides more up to date view of a borrower's circumstances than CRA data does in many instances
- When well implemented, it involves less manual interpretation than handling borrower's bank statements and / or payslips separately

[28] Fair4All Finance's survey, "Understanding the role of technology in Community Finance", Dec 2020

For an FCA regulated lender to be able use open banking within their application process, there are three main requirements:

1. The customer's bank must provide open banking. At the time of writing, the UK's nine largest banks and building societies offer open banking, as well as several smaller banks and building societies, ie most customers in the UK will have access to open banking
2. The customer must give the lender permission for open banking to be used, along with the bank details of their accounts
3. The lender must have an open banking interface, which is integrated with their application processing system so that the data is extracted and processed automatically. It is possible for lenders to develop these interfaces themselves using internal IT resource, but most organisations find it easier to buy an off-the-shelf product from a regulated provider offering open banking solutions. Here is a list of the providers currently being used by Community Finance lenders:

Supplier	Providers using
TrueLayer	12
Lending Metrics	11
Experian	5
TransUnion	5
Account Score	4
Credit Kudos	2
NestEgg	1
Yapily	1
Total	**41**

If a lender has access to open banking for an applicant, then this will usually be the most complete and accurate data source available for determining income and expenditure data that is used to assess affordability. However, there will be cases when open banking data is either unsuitable or insufficient on its own. Some examples of where this can arise are:

- The customer's current account provider does not provide open banking. Therefore, open banking is not available for that customer
- The customer does not use online or mobile banking. These are pre-requisites for the use of open banking, even if the customer has given their consent and their current account provider provides open banking

- The customer conducts some of their regular financial activities outside of their current account. Examples of this are salary being paid directly into a savings account, cash-in-hand work, or where an individual prefers to withdraw their income each month and manage their outgoings in cash. Another example is where people pay most expenses via credit card. The lender would need to ensure that the customer provides Open banking access to the credit card(s) too, as the current account information will only show the monthly credit card payment, not the type of expenditure that was incurred on the card.
- Sometimes, the open banking interface may not return full data. One reason for this is technical issues with the way the bank provides data. Another is errors in the way the interface with the bank has been implemented. This is relatively rare but does happen on occasion
- A customer has not / will not give their consent to open banking. Some organisations say that giving permission for open banking is mandatory for a customer to get a loan. This is perfectly legal and not usually a problem. Good communications to borrowers can also make this decision easier for them. However, good practice for organisations that stipulate this requirement is to assess their target market to ensure that their policy is not unfairly discriminating against certain customer groups for whom open-banking may not be as widely available as the population at large

Consequently, organisations should not rely solely on open banking data. Those who use open banking should have alternative processes in place to gather the information required to calculate affordability and process applications if open banking data is unavailable or incomplete.

Bank statements

Bank statements provide the same type of information as open banking, however it is the responsibility of the individual to get copies of these bank statements and manually provide them to the lender. In addition, banks statements do not display categorised information, which means it is more laborious for the lender to review and categorise the information, potentially across multiple accounts.

The lender can request any number of bank statements upwards of 1 month.

Payslips

Payslips provide salary income information and as with bank statements, it is the responsibility of the individual to get copies of these payslips and manually provide these to the lender. The lender can request any number of payslips upwards of 1 month.

Credit Reference Agency (CRA)

There are 3 principal CRAs in the UK, Experian, Equifax, and TransUnion (formerly Callcredit). A lender can currently use 1,2 or 3 agencies depending on their risk appetite, which will detail what the lender is (and is not) willing accept as part of its lending strategy. Document RM1 gives further information about how lenders can define and manage their Risk Appetite.

CRAs have sight of an individual's credit history, built up of monthly submissions from all lenders that supply to the CRA. In addition, CRAs have various products that lenders can use to validate the income stated on application forms.

Lenders can also receive information held by the CRA on current credit commitments and some contractual payments which can be used as part of the expenditure assessment.

CRAs also have access to various data sources that can be used to help assess "cost of living" expenditure.

The information each lender can receive from the CRA is reliant on the different membership levels associated to each of the CRAs, i.e. it is dependent on what data the lender can provide to the CRA.

CRAs can also act as a third-party Open Banking provider.

It should be noted that a credit check will leave a 'hard search' on the customer's credit file.

We are in the process of producing further guides that will give more details on Credit Reference Agencies.

Statistical data - ONS data or equivalent

Statistical data sources include options such as the Office for National Statistics (ONS). ONS is the UK's largest independent producer of official statistics.

The ONS collect and publish statistics relating to the average household expenditure on goods and services, in the UK, split by age, income, economic status, socio-economic class, household composition and region.[29]

This is a valuable source of information to estimate the individual's expenditure for use in the affordability assessment when other sources of information are unavailable.

However, it cannot be used as a source to verify, derive nor estimate the income of the individual as it does not provide income information at a granular level sufficient for use in the income calculation.

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[29] Expenditure - Office for National Statistics (ons.gov.uk)

Therefore, statistical data is not considered in the below Section 4 which relates to income only and it is not a source sufficient in isolation to be used in the affordability calculation.