Expecting the unexpected

An extract from Perspective: The Responsible Lending Issue
Essential insights into the issues facing your industry today
FCA authorisation, a renewed focus on affordability and the prospect of interest rate rises means lenders are reviewing their policies, procedures and risks. **Consumer credit industry journalist Heather Greig-Smith** talks to the Finance & Leasing Association and British Bankers Association for their perspective on the changing regulatory focus.

While lenders are hard at work preparing for authorisation by the Financial Conduct Authority (FCA), the approach they can expect from the regulator is an unknown quantity. The FCA’s Consumer Credit Sourcebook (CONC) covers responsible lending requirements under CONC 5. Fiona Hoyle, Head of Consumer Finance at the Finance and Leasing Association, says the requirements were consulted on and finalised in a short space of time. “One of the things we don’t have is an idea of FCA expectations.”

She adds: “A lot of the requirements are based on the irresponsible lending guidance but it is far more detailed and written in a slightly different way. Lenders are looking at the requirements set out in CONC 5 and considering whether any changes need to be made.”

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They must consider both the customer’s ability to make repayments and whether the loan will have an adverse effect on the consumer’s financial position.

However, while the mortgage industry has engaged in huge debate over the last 18 months about affordability and stress testing against interest rate rises, Hoyle says the unsecured consumer credit sector has not had the same thematic work and information. “Because this is new, we don’t have that yet. We know the FCA is doing something on high-cost short-term lending and when that is published that will give us some insight about what that looks like in the eyes of the FCA.”

She adds that lenders are adapting to a change in emphasis. “The test for every action that a financial organisation takes is: is that a good outcome for the consumer? That’s the spirit of outcomes-based regulation. This is a very different approach and it will take time for that to bed in.”

That doesn’t mean lenders are waiting to see what happens before they act. Hoyle says they are refining their affordability models and procedures, working with credit reference agencies and ensuring policies are carefully documented. “In October when firms are authorised, the FCA will be looking at the business model. You will have to set out who you lend to and what your underwriting and lending procedures are. All of that will come under focus.”

BBA executive director of retail banking Eric Leenders says creditors who are used to analysing their asset books using measures such as arrears levels, write-offs and net interest margins will now be asked about individual policies, the application of those policies and evidence to support their decisions. “It might be a more granular approach, which could pose a challenge in the automated decisioning environment,” he says.

All of this takes place against a backdrop of interest rate rise speculation and creditors are having to stress test their accounts against that changing economic environment. “Lenders are conducting internal stress testing,” says Leenders. “The challenge they face is in making sure this is wide enough in scope. A rate rise may not affect a fixed-interest loan agreement, but if, for example, the customer’s landlord puts up their rent because his own SVR has risen, it could still have an impact.”

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Hoyle agrees: “Our members will be looking at where there are variable interest rates. If you’re lending to consumers who have mortgages you have to factor in these aspects.”

While the changes require policies and procedures to be honed, Hoyle says responsible lending is already deeply embedded. “Lenders don’t want to lend to consumers who can’t afford the credit and make the payments – that’s the bedrock of all lending decisions.”