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Stephen Timms MP
Chair, Work and Pensions Committee
House of Commons
London
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20 July 2020

Our Ref: SA200708A

Dear Stephen,

<u>FCA's approach to affordable lending and forbearance</u>

Thank you for your letter of 8 July 2020. I am pleased to be able to contribute to your inquiry by sharing some information about our regulatory framework for consumer credit lending.

Whilst in general it is not possible to draw precise parallels in answer to your questions, I hope this insight into our approach will be helpful in your considerations.

Clearly the biggest difference between the DWP regime and the commercial lending regime we supervise is that the FCA regime is designed to prevent consumers being lent to in an unaffordable manner by firms that have a commercial incentive to provide credit to them (either to make a profit on that lending or assist the sale of goods linked to the credit). By contrast the DWP regime is intended to provide public support to individuals.

1. Affordability

   The objective of our creditworthiness rules and guidance is to protect consumers from being granted credit that is predictably unaffordable at the point it is taken out. At the same time, we want consumers to be able to access credit if they are likely to be able to repay. We want firms to make a reasonable assessment, not just of whether the customer will repay but also of their ability to repay affordably and without this having a significant adverse impact on their financial situation and their ability to afford non-discretionary expenditures. Non-discretionary expenditures include "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."[1]

   Our specific creditworthiness assessment rules and guidance are set out in our Handbook and include the factors that firms should take into account in deciding whether a consumer could afford to make repayments.[2]

   We avoid being too prescriptive to reflect the fact that the rules and guidance have to be applied to a broad range of products and consumer situations and to avoid harmful unintended consequences, including for the cost and availability of credit. Our approach to affordability enables flexibility for the firm according to the nature of the product and the

[1] CONC 5.2A. 18: https://www.handbook.fca.org.uk/handbook/CONC/5/2A.html#D152
[2] CONC 5.2A: https://www.handbook.fca.org.uk/handbook/CONC/5/2A.html#D152

customer base. This covers a wide spectrum of consumers in very different financial circumstances.

Assessments by financial services firms must be reasonable and based on sufficient information, for example taking into consideration income and non-discretionary expenditure. Factors such as the size of the loan, its duration, and the interest rate should have an impact on determining the rigour with which the assessments should be conducted and the information that is needed. We set out more fully the thinking behind our approach in our Policy Statement 18-19 on 'Assessing creditworthiness in consumer credit', which your team may find useful.[3]

2. Forbearance

We also have a framework of rules and guidance covering where a customer is in default or arrears difficulties.[4] Firms must treat these customers with forbearance and due consideration. We give some examples of what this may include such as allowing deferment of payment of arrears or accepting token payments for a reasonable period. Firms should allow reasonable time and opportunity for the customer to repay the debt. Firms must also have effective procedures for the fair and appropriate treatment of customers who may be particularly vulnerable. Forbearance can include writing off debts in some circumstances.

Our rules also govern contact with customers for the purposes of debt collection, for example precluding contact at unreasonable times or in a way that is likely to be publicly embarrassing to a customer.[5]

3. Communications about loans and debt write-offs

There are comprehensive rules and regulations governing the information that lenders must give their customers about the terms, amounts owed, repayment schedules, interest, fees and charges, and the consequences of non-payment, amongst other matters.

Claims for debts must be made within a prescribed period (generally six years in England, Wales and Northern Ireland and five in Scotland) otherwise the debt is statute barred. Our rules prevent firms from attempting to recover a debt if they have not been in contact with the customer during the limitation period.[6]

I trust that this has been helpful. Given the considerable depth and breadth of the consumer credit regime my team would be happy to meet with your officials and give them a fuller briefing.

Best wishes

Chris

Christopher Woolard
Interim Chief Executive

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[3] https://www.fca.org.uk/publication/policy/ps18-19.pdf
[4] CONC 7: https://www.handbook.fca.org.uk/handbook/CONC/7/?view=chapter
[5] CONC 7.9-7.12: https://www.handbook.fca.org.uk/handbook/CONC/7/?view=chapter
[6] CONC 7.15: https://www.handbook.fca.org.uk/handbook/CONC/7/?view=chapter

Work and Pensions Committee
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From the Chair

Christopher Woolard
Chief Executive
Financial Conduct Authority

8 July 2020

Dear Christopher,

The Work and Pensions Select Committee is currently undertaking an inquiry into the wait for a first payment in Universal Credit, with a focus on identifying solutions to the problems people face because of the 'five week wait' for their first award.

Currently, new Universal Credit claimants can request an Advance, equivalent to 100% of their estimated monthly award, which must be repaid over 12 months (although this is set to increase to 24 months from October 2021). Around 70% of claimants take out the maximum entitlement, which as a minimum consists of the standard allowance (at least £342.72), plus additional elements for housing costs, children and people with disabilities or health conditions. This means that many claimants are effectively taking out loans equivalent to several hundred or in some cases over one thousand pounds.

Monthly repayments are paid at a fixed rate, which is currently capped at 30% of the standard allowance in Universal Credit. We have heard evidence from a number of organisations about the hardships that these repayments are creating for claimants, leaving many people trapped in cycles of debt and unable to meet living costs.

Many charities that support claimants have recommended that DWP should adhere more closely to private sector standards on responsible lending. StepChange, the anti-debt charity, has recommended that DWP should comply with the consumer credit regulatory framework overseen by the FCA. It suggests that this could be achieved through the following measures:

- accepting industry-standard affordability assessments, adjusting and deferring repayments where appropriate;
- introducing a single 'one stop shop' point of contact for those affected by deductions; and
- improving communications by providing sufficient notice and clear information about deductions, and signposting to free debt advice.

We understand, of course, that public sector debts fall outside your remit. You will, however, recognise that it is important that the public sector should learn lessons, where possible, from good practice elsewhere. Some years ago, problem debt was predominantly linked to high cost credit. In recent years—not least because of the FCA's regulatory approach—it has become more common for public sector debt to be the cause of difficulties. The National Audit Office concluded in 2018 that the Government "lags behind" the retail lending sector in implementing good debt management practice and could learn from it.

The FCA has a great deal of expertise on responsible lending in the retail sector. We would therefore be grateful for your assistance in our inquiry. In particular, it would be very helpful to have a response from you to the following questions about DWP's approach to lending:

1. **DWP does not conduct an affordability assessment before allowing claimants to take out an Advance. In your view, should the Department carry out affordability assessments as a matter of routine?**
    a. **What would the FCA's view be of a private sector lender which made loans of this size without an affordability assessment?**

2. **In most cases, Advances are currently paid back at a set rate per month and for a fixed period. In your view, is this good practice?**
    a. **Should the Department take a more tailored approach to repayments, which reflects the needs of the individual?**
    b. **What flexibility would you expect to see on repayment plans in the private sector? Would you expect options such as pausing repayments to be offered proactively?**

We have heard evidence that many Universal Credit claimants are repaying previous overpayments of tax credits, compounding the hardship caused by Advance repayments. Many of these people were not aware of these debts (some of which date back many years) until they made a claim for Universal Credit.

3. **What is your view of the Government's approach of only informing people about these debts, and beginning to require repayments, when they move to Universal Credit?**
    a. What view would the FCA take of a private sector lender which behaved in this way?
    b. Would you expect a debt to be written off after a certain period if the lender had failed to tell the customer about it?

4. **What else could the Department usefully learn from best practice in private sector lending?**

To assist us in our inquiry, we would be grateful for a response by **Monday 20 July**.

Yours sincerely,

Rt Hon Stephen Timms MP
Chair, Work and Pensions Committee