GOWLING WLG

CONSUMER CREDIT AFFORDABILITY ASSESSMENT UNDER CONC - ARE YOU READY?

17 October 2014

Firms carrying on consumer credit-related regulated activity need to ensure that they are complying with the requirements set out in the Consumer Credit Sourcebook (CONC), which came into force on 1 April 2014, including in relation to determining the affordability of the agreement for the consumer.

The six-month transitional period allowed by the FCA to give firms time to become familiar with the new structure and style of the rules and guidance ended on 1 October. Firms are now expected to abide by the new rules - not the old Consumer Credit Act requirements and Office of Fair Trading guidance.

Given the high levels of consumer debt in the UK, a particular area of focus for the FCA will be on affordability and creditworthiness assessments. The FCA wants to ensure that lending is responsible and that a proper assessment has been taken as to whether the consumer can afford and sustain the relevant payments, both at the point of purchase and over the lifetime of the agreement. The assessment is now **both** creditor- and borrower-focused, with the requirement to assess sustainability entailing a forward-looking stress-testing exercise. An over-indebted customer is likely to be a vulnerable customer.

The CONC provisions on responsible lending are found in CONC 5. This sets out the type of agreements to which the various provisions apply and the nature of the assessments which must be carried out in respect of the differing agreements to which the provisions relate. It provides in general terms that:

- **5.2.1 R** before making a regulated credit agreement (to which this provision applies) the firm must undertake an assessment of the creditworthiness of the customer. It must consider the potential for the commitments under the regulated credit agreement to adversely impact the customer's financial situation. The information known to the firm at the time the regulated credit agreement is made and the ability of the customer to make repayments as they fall due over the life of the regulated credit agreement must be taken into account. The creditworthiness assessment must be based on sufficient information obtained from the customer and a credit reference agency, where appropriate and necessary.

- **5.2.2 R** deals with the assessment that needs to be undertaken in relation to certain defined regulated credit agreements which are not included in the above requirements but still require an assessment of the potential for the commitments under the agreement to adversely impact the customer's financial situation.
- **5.2.3G** sets out that the extent and scope of the creditworthiness assessment or the assessment required by CONC 5.2.2 R, in a given case, should be dependent upon and proportionate to one or more of the following – the type, amount and cost of credit; the financial position of the customer at the time of seeking the credit including the customer's credit history and any financial difficulties; the customer's existing and future financial commitments; any future changes in circumstances which could be reasonably expected to have a significant financially adverse impact on the customer; and the vulnerability of the customer.
- **5.2.4 G** provides that to consider all of the factors set out in CONC 5.2.3G in all cases is likely to be disproportionate. A firm should consider what is appropriate dependent upon, for example, the type and amount of the credit being sought and the potential risks to the customer. It should also consider the types and sources of information to use in the assessments required of it, including its record of previous dealings; evidence of income and expenditure; a credit reference agency report; and information provided by the customer.
- **5.3.1 G** deals with creditworthiness and sustainability and provides that in making the assessments required of it the firm should take into account more than the customer's ability to pay. It should also take reasonable steps to assess the customer's ability to meet repayments in a sustainable manner without the customer incurring financial difficulties or experiencing significant adverse consequences. Evidence of future increases in income and decreases in expenditure may be taken into account if the repayments are expected to be sustainable in the light of those changes. Any assumption regarding future income should be reasonable and capable of substantiation in the individual case.

Sustainability is held to mean that repayments can be made over the lifetime of the agreement (or if there is no fixed duration, within a reasonable period) and out of income and savings without undue difficulties i.e. on time, while meeting other reasonable commitments and without having to borrow or realise security or other assets to meet the repayments.

Full details of the requirements can be found in the FCA handbook.

Comment

The FCA have said that affordability and creditworthiness are two of their areas of focus.

Affordability and creditworthiness mean different things and this requires changes to policies and procedures, albeit proportionate changes.

Most firms will by now have reviewed the adequacy of their underwriting systems and lending criteria to ensure they have, and have implemented, clear and effective policies and procedures to make the reasonable assessments required and to ensure that the information on an application for credit relevant to the assessment is complete and correct. This includes information supplied by the customer. If not, such an exercise should be undertaken without delay.

When the FCA arranges to visit, firms will need to be able to demonstrate the appropriateness of their affordability assessment and show that the assessment resulted in the right outcome for the customer.

It is too early to say yet just how vigorous the FCA will be, but it is expected that there will be challenges to some affordability assessment models. The pay-day lenders might currently be in the FCA's focus, but how long will it be until they cast their nets more widely?

Readers may be interested in our previous alert detailing the changes brought in by the FCA.

Related Banking & Finance

Author(s)

Greg Standing

Head of Enterprise Risk Management,
Birmingham

Email

greg.standing@gowlingwlg.com

Phone

+44 (0)121 393 0653

vCard

Greg Standing