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Briefing Doc - MFR CCA & Non-Bank Mortgage Lenders



Detailed Briefing Document

MFR CCA & Non-Bank Mortgage Lend

Date: 24 October 2024

Source: "Multi-firm review of consumer credit firms and non-bank mortgage lenders," Financial Conduct Authority (FCA), 23 October 2024

Key takeaways:

Widespread need for improvement in risk management: The FCA review found that the majority of consumer credit firms (CCFs) and non-bank mortgage lenders (NBMLs) need to improve their risk governance and management frameworks.

Inadequate preparation for economic challenges: Many firms were not adequately prepared for the changing economic environment, including rising interest rates and cost-of-living pressures, leading to squeezed margins and potential liquidity issues.

Lack of comprehensive risk identification: Some firms failed to fully consider crucial external risks such as credit, counterparty, liquidity and funding, operational and market risks, leaving them vulnerable.

Underdeveloped stress testing and wind-down planning: Many firms displayed inadequate stress testing procedures and a lack of wind-down planning, increasing the risk of disorderly failure and harm to consumers.

Detailed Observations:

Identifying risks relevant to the business:

Good Practice: Most firms demonstrated a good understanding of credit risk and employed effective borrower credit assessment. Some firms leveraged group resources for financial monitoring.

Areas for Improvement: Some firms lacked financial risk metrics for adequate capital and liquidity levels.

Inadequate consideration of risks beyond credit risk, such as interest rate and liquidity risks.

Lack of quantitative assessment of risks posed by business partners, particularly Appointed Representatives (ARs). "We encourage firms to develop methodologies to quantify the risk associated with oversight of AR risk as appropriate."

Setting risk appetite and establishing appropriate systems and controls:

Good Practice: Some firms demonstrated a clear risk appetite with defined risk profiles and acceptable risk thresholds.

Robust business planning and forecasting, including regulatory capital position projections.

Proactive liquidity management with established triggers and buffer levels.

Well-developed risk management and oversight processes, including three lines of defence approach and use of external support.

Areas for Improvement: Lack of clearly defined financial resource adequacy levels and intervention triggers.

Reliance on basic financial statements and limited financial data for decision-making.

Over-reliance on group-level reporting, leading to poor visibility of individual entity financial positions.

Absence of processes for identifying and responding to new and emerging risks.

Lack of mechanisms to review and manage interest rate risk.

Undertaking stress testing and considering wind-down planning:

Good Practice: Consideration of interest rate risk and stress testing to assess impact on margins and profitability.

Assessment of the full impact of economic changes on business, rather than isolated metrics.

Utilisation of natural hedging in some cases to minimize interest rate risk.

Areas for Improvement: Underdeveloped stress testing, often failing to cover the full risk profile of the firm.

Inadequate frameworks for identifying future funding needs and potential liquidity stresses.

Lack of contingency funding plans to address potential liquidity shortfalls.

Limited increases in loan loss provisions or capital ring-fencing despite rising loan repayment arrears.

Overall lack of adequate wind-down planning. "We expect firms to consider their own responsibilities and plan to ensure that they take actions to minimise the impact of firm failure, on both customers and markets, at the appropriate time."

FCA Expectations and Next Steps:

The FCA expects firms to review their operations in light of these findings and implement necessary improvements. They emphasize the importance of:

- 🕒 Developing comprehensive risk management frameworks in line with FG20/1 guidelines.
- 🕒 Conducting robust and comprehensive stress testing, considering severe yet plausible scenarios.
- 🕒 Establishing and implementing effective wind-down plans to mitigate consumer harm and ensure market integrity in case of failure.

The FCA will continue to monitor firms' approaches to financial resilience and consumer risk as part of its ongoing supervisory activities.

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5. **In-Depth Compliance Training and Education: Build a culture of compliance.**
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