The LSB's Information for Practitioners

The Standards of Lending Practice for business customers – Asset Finance

Credit risk management

May 2021

This document has been produced by the LSB and provides non-exhaustive examples of the approach Registered Firms (Firms) may wish to take into consideration when seeking to adhere to the Standards of Lending Practice for business customers (the Standards) on credit monitoring.

Registered Firms must be able to demonstrate to the LSB that they are adhering to the Standards of Lending Practice; however the LSB does not monitor compliance with the content of this document and as such, it is not intended to be prescriptive nor binding on Registered Firms. The LSB acknowledges that each Firm will have its own way of demonstrating that it is adhering to the Standards without the need to refer to, or take account of, the content of this document.

Where a reference to made to the Consumer Credit Act 1974, as amended (the CCA), the Consumer Credit Sourcebook (CONC), other Financial Conduct Authority (FCA) requirement or wider legislation, the examples or suggestions which follow represents the LSB's view on how the Standard could be achieved.

This document will be kept under review and updated to reflect examples of good practice being undertaken across the industry in this area.

Customer outcome: business customers will be supported by pro-active and reactive measures designed to identify signs of financial stress

Firms will achieve this: with systems and controls that are capable of identifying, across the relevant products held, where customers may be showing signs of financial stress and pro-actively engaging with the customer to agree an appropriate solution.[1]

This section of the Standards of Lending Practice is seeking to ensure that customers who may be at risk of falling in financial difficulties are identified and supported at an earlier stage so that pre-emptive action can be taken.

1. The customer should be told what information, if any, will be required to allow the Firm to monitor the business' performance and how and when this should be provided

The information required by firms to monitor business performance may vary, depending on the size of the business, the level of borrowing provided to the customer and the firm's approach to customer segmentation. In practice, this means that some firms may not request any information from businesses as part of the credit monitoring process, relying instead on internal account performance and external credit data, particularly, where the relationship is managed at arms-length, through a transactional only model.[2] Whilst the LSB acknowledges that the transactional nature of asset finance products may limit the ability to pro-actively identify customers at risk of financial difficulty, Firms should ensure that there are mechanisms in place to provide timely support to customers, for example building early warning triggers which prompt the firm to contact the customer, such as a missed payment or by encouraging customers to approach the firm for early assistance.

Where monitoring information is requested, registered firms are encouraged to be transparent and clear about what information is required from the business customer, when this must be provided by, and how this will be used by the firm. This information should be relayed to the customer at the very outset of the relationship so that they understand what is required of them through the duration of their relationship. The LSB would encourage firms to guide customers to relevant information on their websites or to external sources, to support the customer in providing this information. This may be more relevant to customers who are at the smaller end in terms of the scope of the Standards or for start-ups/very young businesses.

Where appropriate, firms may consider the use of covenants to formalise the requests for monitoring information. The LSB considers this to be a business decision, however where covenants are used, the customer should understand their obligations under the agreement, particularly in respect of providing information and the frequency of the request, including, where applicable, an understanding of how the monitoring information will be used to monitor other financial covenants which may be required, and the consequences of non-adherence.

[1] The customer has not yet defaulted but information available to the Firm suggests that the business may be showing signs of being in financial difficulty.

[2] Where the business is not relationship managed (expand definition)

2. **As appropriate, a sufficient level of monitoring of a customer's borrowing should be undertaken to help determine if the customer is exhibiting signs of financial stress. Where relevant, appropriate support should be offered**

For businesses that are relationship managed, the knowledge of the firm, coupled with the regularity and type of contact, lends itself to a more direct relationship with the customer where the opportunity to identify potential signs of financial stress are greater. Firms should ensure that these opportunities to engage with the business are fully optimised. This may be achieved through setting a business review date, providing the Firm with an opportunity to identify and query deviations to business performance, profile and strategy, based on a review of historic and current financial performance against projected performance, including any significant changes to the core management team.

Where a review process exists, firms should ensure that their staff document the observations made through the review, and that where there is evidence of financial stress, further action is taken to support the business. Depending on the structure and remit of the relationship manager's role and the availability of specialist teams, the support may be offered through the relationship manager or via escalation to a specialist team. Where there is a specialist team in place, firms should ensure that the structure and remit of these teams, including the triggers for referral, are firmly understood by staff.

Where the relationship is managed through a transactional only model, firms may not have access to regular business and financial information to identify whether a business is showing signs of financial stress, particularly where the regularity in customer contact is limited. Firms must explore the different types of information or data it does have access to, including any relevant information obtained at the product sale stage, supported by internal account performance data including business income and expenditure, the use of early warning triggers, and where available, the use of external credit information.

The firm may also wish to use the product renewal process to assess the suitability of the product based on patterns of utilisation, business strategy, its ongoing needs and repayment history.

3. **Firms should have appropriate triggers and processes in place to help identify customers who are showing signs of financial stress and should engage with these customers in a supportive and open manner**

A registered firm's approach to identifying and supporting customers at risk of financial difficulty may vary, depending on the firm's business model, its approach to customer segmentation, the distribution channel by which the customer is serviced and the nature and regularity of the interaction. It is important to recognise the diversity in firm's operating models, and the scope and breadth of the distribution channels and servicing models offered. We recognise that not all firms will offer a digital, transactional only model, others may opt to service their entire business customer base through a bespoke, relationship managed proposition and there may be some customers that are managed through a third party such as a broker or an intermediary. Firms should factor this into their decision making, when determining the most appropriate approach to pro-actively identifying and engaging with customers. Where the firm offers more than one distribution channel, firms should seek to stream-line their approach to ensure all businesses, irrespective of the size and type of facility, are identified and supported through whichever channel they engage.

Developing and defining meaningful behavioural and product triggers can help drive a predictive and pre-emptive approach to identifying customers at risk of financial difficulty. Whether the approach derives from internal account performance or external credit data, the triggers and the supporting parameters for identifying customers at risk, should be bespoke and built around the firm's core operating model. This could be supported by a pro-active contact strategy, which utilises and explores a range of contact methods and distribution media to ensure that customers are appropriately notified, that the contact is timely, and the customer is receptive to the offer of support. We acknowledge that there may be challenges to engaging with customers, with some business customers more receptive to engaging in discussions around their situation, while others may be less likely to disclose the full extent of their situation, for fear that this information may have a negative or adverse impact on the view the firm has on the business. Whilst the type and method of contact is key here, firms should consider how the message will be received by the customer, how the information will be used and what action they would like the customer to take. The tone of voice and construct of the message is critical to relaying the content of a message to encourage meaningful contact, build transparency and strengthen trust.

Whilst a pro-active strategy is useful in encouraging contact and engaging with businesses, some customers may choose to contact a firm, where they self-identify that they require support. The notification to a firm may follow a change in circumstance, for example, the loss of a key contract impacting a business's ability to maintain further repayments to the firm, an increase in business expenditure or the depletion in business performance. Firms should ensure that they have appropriate mechanisms and support structures in place to fully support these customers, and that they are not turned away.

The LSB would encourage firms to raise awareness of the type of support it can offer its customers who are, or may be, experiencing financial stress. The provision of information is critical to building trust, ensuring transparency whilst dispelling any concerns that the contact is focused on exacerbating the business' financial situation. The LSB would encourage firms to direct business customers to appropriate sources of information. This may include information on the firm's website, for example, through a dedicated section detailing its approach to supporting customers at risk of difficulty, with details of the support available and contact information, should the customer wish to engage further with the firm. This could also be supported by web chat facilities should the customer wish to explore the availability of support. The provision of web chat facilities, offers the business an opportunity to contact the firm discreetly, though where possible, the firm should encourage the customer to engage in a fuller discussion around their circumstances. Depending on the structure and remit of the support available, the firm may wish to direct the customer to a specialist team, with the knowledge and skills to offer the right level of support, at the right time.

Whilst the list below is not intended to be exhaustive, it sets out the types of triggers that firms or their intermediaries may look out for which may suggest that a customer is experiencing financial stress:

- missed/delayed payments;
- regularly overdrawn without agreement;
- large increases or decreases in turnover;
- business is trading at a loss;
- inadequate economic or financial structure;
- insufficient cash flow to meet financial obligations;
- inability to obtain further funding or refinancing;
- persistent losses;

- the business suddenly loses a key customer or employee;
- a large part of the business is sold;
- the customer does not keep to conditions set out in the loan agreement, without adequate rationale;
- the customer does not supply agreed monitoring information on time; and
- another creditor brings a winding-up petition or other legal action against the business.

Firms should exercise discretion as to whether the event would result in contact with the customer based on the parameters set by the firm, and where relationship managed, their knowledge of the business customer.

Firms should also be aware of the link between credit monitoring and customer vulnerability – establish the similarities in approach and how these customers should be dealt with in a positive and sensitive manner.

4. Firms should ensure that relevant customer facing employees are sufficiently trained and skilled to help them to identify and deal with those customers who may be showing signs of financial stress

Firms should invest in staff training to ensure that customer facing employees and where appropriate, third parties have the appropriate skills and knowledge for their role to support the identification of triggers and to encourage fuller conversations with a business customer. This should be underpinned by a comprehensive training and competence framework, to ensure knowledge is maintained and to encourage consistency in the level and depth of training delivered.

Whilst section 4, above, refers to the development of system based triggers which may derive from a combination of account performance or external credit data, firms should have mechanisms in place to identify instances where information is volunteered by a customer. Some customers may offer this information directly, others may approach the conversation with a degree of reticence, or in a much softer and less overt way, evidenced through the customer's actions or conversation with the firm. Training may be based on information volunteered by the customer during conversation such as 'business expenditure has increased significantly,' 'we have noticed a decline in sales performance,' which may or may not be supported by discrepancies in internal account performance. This should be supported by softer behavioural triggers which, whilst not obvious, may indicate that the business requires further support. Whilst we recognise that not every trigger may result in a customer being identified as being in financial stress, they are clues which should be probed and explored further to encourage a complete understanding of the customer's situation, based on a 'tell us once' approach.

Firms should develop triggers to assist staff in the identification of business customers at risk of financial difficulty. This includes the soft skills required to probe for further information in a positive and sensitive manner if there are indications that the customer may benefit from additional support in managing their finances. This is reinforced by the fact that not all customers will be forthcoming with information because of the perceived consequence on the business, or for fear that the information may be shared more widely.

Relationship managers have a unique insight into how a business is operating and information provided by the customer regarding their business can be used to support conversations with customers who appear to be showing signs of financial stress or where account information or a change in the operating environment suggests that the business may be at risk of difficulties. However, there are challenges to engaging with customers on this topic and some may be unwilling to engage in discussions around their financial situation. Others may be more forthcoming with information but may, for example, be wary of disclosing the full extent of their situation as they lack an understanding of how the content of the conversation will be used by the firm. Therefore, an ability to empathise and explore the customer's concerns about disclosing information is an important part of the process, supported by an explanation of how the information will be used.

Case reviews involving reviewing recorded calls, where these are available, can provide an opportunity for relationship managers to assess how well they are doing. By listening to randomly selected calls and discussing how the call was handled, firms can determine if there is anything that could have been done differently and whether the right customer outcome was achieved. Additional training and support could be provided to address any specific needs on an individual basis, or more widely, in relation to process improvements.

A blended learning technique, using elements of theory and practical examples can help to ensure that staff have the opportunity to put their new skills into practice and can demonstrate their competence though various exercises and knowledge checks. Where specialist teams exist, the opportunity to shadow internal departments to see first-hand how those areas support customers can further embed understanding of pre-arrears and provide a valuable wider perspective whilst strengthening awareness of the specialist teams and their role and remit.

Firms could develop various aids and techniques for ensuring the knowledge is retained once training is complete. This could include desk aids, interactive colleague learning platforms or using the intranet to assist in identifying appropriate actions, underpinned by the need to ensure the delivery of fair outcomes.

What might good practice look like? Specific training is provided so that staff can recognise early vulnerability indicators and what steps they should take if such factors become evident, this training includes case studies that are relevant to the products staff may deal with. Supporting material is accessible and well understood by collections staff who can be seen to apply them in practice.

What might poor practice look like? Collections staff do not to show empathy to the customer and are not trained on how to respond to, and deal with, customers who engage but who tell them of problems or difficulties in meeting their liabilities.

5. Where a customer is identified by an intermediary as showing signs of financial stress, a referral process should be in place which enables the Firm to deal with the customer in line with its policies and processes

This Standard seeks to ensure that where a customer relationship is managed through an appointed intermediary, there are clear processes in place for the intermediary to notify and refer customers showing signs of financial difficulty to the firm. This is to ensure that the firm is able to support the customer at an early stage, in line with their policies and procedures, through the application of tailored solutions.

As this referral means the firm and customer may not have had a direct relationship, firms should make use of all information and data available to them to create a view of the customers finances.

6. Firms should undertake monitoring and assurance work to ensure that their policies and processes are designed and are operating effectively in identifying and supporting customers who are showing signs of financial stress

While firms are at different stages in the development of strategies, designed to prevent customers falling into financial difficulty, consideration should also be given to its ongoing evaluation, to ensure that the strategy continues to operate in a manner that is conducive to the delivery of fair customer outcomes. This may be achieved through the:

- ongoing review and assessment of the design and operational effectiveness of policies, processes and training, along with an assessment of the internal control framework;
- use of case reviews to test the full customer journey, forming a view on the overall effectiveness of the firm's strategy, the response to a situation and the appropriateness of the solution offered. This approach could be used to focus in on a particular aspect of the journey and be scaled to ensure a sufficient number of cases are reviewed to form an opinion, whilst highlighting any opportunities for improvement;
- the development of customer feedback mechanisms to explore the practical impact of the current structures in place.

Firms should consider the risks to customer outcomes associated with the prevention of customers falling into financial difficulty and this should be factored into a firm's assurance and oversight plans, across the three lines of defence.