



FINANSTILSYNET

THE FINANCIAL SUPERVISORY
AUTHORITY OF NORWAY

Circular

Finanstilsynet's guidelines on prudent consumer lending practices

CIRCULAR:

5/2017

DATE:

07.06.2017

THIS CIRCULAR IS APPLICABLE TO:

Banks

Finance companies

Branches of foreign financial institutions

FINANSTILSYNET

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1. Background

The present guidelines are intended to contribute to prudent consumer lending practices. This will reduce the risk of borrowers assuming debt obligations that they are subsequently unable to service, and will contribute to solid financial institutions. The guidelines may also contribute to financial stability and public confidence in the financial industry.

2. Basis in law

The guidelines take a basis in the provisions on good business practice enshrined in the Financial Institutions Act 2015 and the Financial Supervision Act's precept of protecting consumer interests. The Financial Institutions Act 2015, section 13-5, subsection (4) on prudent operation requires financial institutions to conduct their business with integrity and in accordance with good business practices. The Financial Institutions Act 2015 section 16-1, subsection (4) on the organisation of customer service requires financial institutions to organise their business in such a manner that there is little risk of interest conflicts between the institution and its clients or between the institution's clients, or of customer treatment that conflicts with the requirements of good business practice. Financial institutions shall have in place satisfactory arrangements and procedures to identify and in the event mitigate such risk factors in the various areas of the business.

The guidelines also build on the Financial Contracts Act section 46(b) which requires lenders, before a credit agreement is entered into, to assess the borrower's creditworthiness based on adequate information obtained from the consumer and if necessary from a relevant database.

Finanstilsynet points out that other legislation also has a bearing on lenders' granting and marketing of loans. Financial institutions' must meet the Financial Contracts Act's information requirement in their marketing, prior to agreement signing and during the credit relationship. This includes providing the borrower with adequate explanations in accordance with the requirements of the Financial Contracts Act.

Finanstilsynet underlines financial institutions' responsibility for ensuring that agents operating on behalf of an institution are compliant with the requirements to which the institution itself is subject; see Finanstilsynet's circular 16/2009. This responsibility applies to all aspects of the agent's conduct on the institution's behalf, including the marketing of consumer loans and provision of oral and written information to the customers. Financial institutions must ensure compliance through training and ensuing follow up of those agents with whom it has an agreement. Financial agents may not have sub-agents.

Financial institutions must establish a framework for robust and responsible product development and distribution for use for example in the designing of new financial products, including consumer loans. This requirement follows from the Guidelines on Product Oversight and Governance Arrangements for Retail Banking Products, published by the European Banking Authority (EBA) in 2016. The guidelines are available at: <https://www.finanstilsynet.no/regelverk/eba-anbefalinger/eba-anbefalinger/eba-guidelines-on-product-oversight-and-governance-arrangements-for-retail-banking-products-pog/>

Guidelines on remuneration requirements of sales staff were adopted by the EBA in 2016. The guidelines, which set general rules for remuneration of sales staff, are designed to promote consumer protection and apply to the selling of various financial products, including consumer loans. They require financial institutions to have in place internal procedures and incentive arrangements that promote fair treatment of customers and thereby reduce reputational risk. The recommendation receives further mention on Finanstilsynet's website: <https://www.finanstilsynet.no/regelverk/eba-anbefalinger/eba-anbefalinger/guidelines-on-remuneration-of-sales-staff/>

The above body of rules represents key regulation that financial institutions are required to comply with when granting and marketing consumer credit. It is not an exhaustive overview.

3. Supervisory follow up

Section 3 of the Financial Supervision Act requires Finanstilsynet to ensure that the institutions it supervises operate in an appropriate and proper manner in accordance with law and provisions laid down pursuant to law and with the intentions underlying the establishment of the institution, its purpose and articles of association. Finanstilsynet shall ensure that the institutions it supervises attend to consumer interests and rights in their activities.

The present guidelines express what Finanstilsynet considers to be prudent credit practice and credit assessment, i.e. what the Authority sees as good business practice in this area. They will apply both to Norwegian banks and other financial institutions, as well as Norwegian branches of foreign financial institutions. They will be a part of the precept of the 'general good' in that their aim is to protect the interests of consumers and the public at large.

Financial institutions are expected to bring their internal procedures and policies into line with the requirements of these guidelines and to put in place arrangements for internal reporting to the institution's board of directors, or to the branch manager in the case of Norwegian branches of foreign financial institutions, on the institution's compliance with the guidelines.

Finanstilsynet will oversee compliance with the guidelines through reports filed by the institutions and through its supervisory activity. Compliance with the guidelines will be part of the basis for risk assessment and for setting capital charges under Pillar 2.

Finanstilsynet expects institutions to start work immediately on bringing their internal policies into line with Finanstilsynet's guidelines.

4. Finanstilsynet's guidelines for prudent consumer lending practices

1. Scope

These guidelines apply to financial institutions and branches of foreign financial institutions in Norway.

The guidelines cover the granting, or increase of the amount of, credit to consumers (consumer loans, including credit offered via credit cards and payment cards).

2. Documentation of credit assessment

A financial institution shall provide documentary evidence that its granting of, and increase of the amount of, consumer loans is based on a prudent credit assessment utilising information about the borrower's income, expenses and debt and wealth position. Income and wealth information should always be checked against tax assessment data, in the event also by obtaining the customer's income tax return. Debt information should always be checked against a debt registry¹. A financial institution should check relevant registers for any payment default registered against prospective borrowers.

3. Debt servicing capacity

A financial institution shall calculate a borrower's ability to service their loan based on the borrower's gross income and all relevant expenses, including interest, loan instalments and normal living expenses. When assessing the borrower's servicing ability, the financial institution should factor in an interest rate increase of at least 5 percentage points from the prevailing level of interest on the borrower's overall debt. For lines of credit, the assessment should be based on full utilisation of the credit line.

If the borrower lacks sufficient resources to meet normal living expenses after a 5 percentage point interest rate increase, the loan should not be granted.

A borrower's credit line should not be increased without the borrower applying for this to be done.

4. Debt ratio

A financial institution should not grant a consumer loan that increases the borrower's overall debt to more than five times the borrower's gross annual income.

5. Instalment payments

Consumer loans should carry requirements on instalment payments and maximum loan term. A financial institution should not grant loans with a term above five years.

Where a credit line has been fully drawn down over time, the financial institution should arrange for it to be converted to an amortisation loan.

¹ As at 6 June 2017 a debt information bill has been considered by the parliamentary Standing Committee on Family and Cultural Affairs; see Innst. 356 L (2016-2017).

6. Simplified treatment of loan refinancing and credit cards with a low credit limit

The guidelines' requirements on debt servicing capacity and debt ratio do not apply where one or more consumer loans are replaced by a new loan (refinancing), and where the refinanced loan:

1. does not exceed the size of the existing loan at the refinancing date,
2. has a term that does not exceed the residual term on the existing loan² and
3. carries the same, or more stringent, requirements on instalment payments as the existing loan

The guidelines' provisions on debt servicing capacity, debt ratio and instalment payments do not apply where applications for a credit card with a maximum credit limit of NOK 25,000 are concerned, provided the applicant does not already hold a credit card.

7. Reporting

Financial institutions shall each quarter submit a report to the institution's board of directors, or branch manager in the case of branches of foreign institutions, on the institution's compliance with these guidelines. The report shall include an overview of any deviation from the requirements on debt servicing capacity, maximum debt ratio and instalment payments.

8. Supervisory follow up

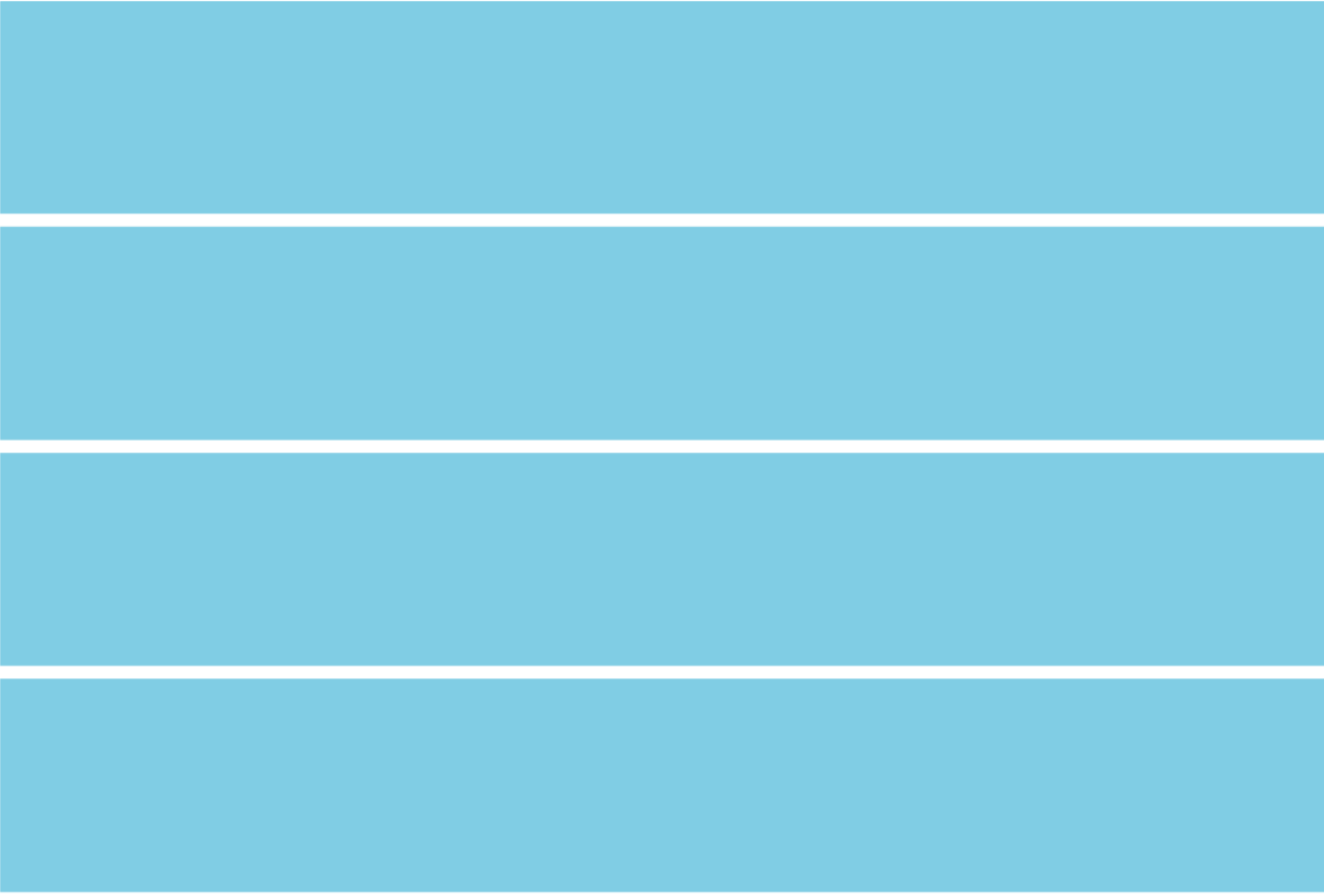
Finanstilsynet will base its follow up of financial institutions on these guidelines from and including the fourth quarter of 2017.

Contact persons:

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² This does not apply to applications for forbearance based on payment difficulties. For reference, see the EBA's guidelines on arrears and foreclosure: <https://www.finanstilsynet.no/regelverk/eba-anbefalinger/eba-anbefalinger/eba-guidelines-on-arrears-and-foreclosure/>



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