

Policy Statement

PS23/8

Mortgage Charter: enabling provisions

June 2023

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1 Summary

- 1.1 We are amending our Mortgages and Home Finance: Conduct of Business (MCOB) sourcebook to support the implementation of the Government's Mortgage Charter, published on 26 June 2023. The changes enable mortgage lenders to meet their commitments under the Charter, which builds on the previous work we and lenders have done to support borrowers.
- 1.2 In June 2022, we issued a 'Dear CEO' letter to lenders, setting out our expectations of how they can support their customers given the increasing cost of living. Our recent Guidance published in March 2023 set out further ways firms could offer support in line with our existing rules.
- 1.3 We are currently consulting on making our Tailored Support Guidance (TSG) permanent. We issued the TSG during the pandemic for mortgages, overdrafts and consumer credit. Our proposals strengthen what we expect from lenders when dealing with customers who need tailored support, often through forbearance.
- 1.4 All borrowers are having to manage financial challenges from the increased cost of living. Those on expiring fixed and variable rate mortgages are also facing the rising costs of increased interest rates. Over the next 12 months, 1.7 million fixed rate deals will expire, with 893,000 expiring before the end of this year. Many of these fixed rate deals were agreed at a time when interest rates were at an historic low. The median interest rate for deals expiring in Q3 2023 is 2.07% and in Q4 2023 is 1.95%. In contrast, median rates for new deals today are currently above 6% and expected to rise further. Over the next year we expect many borrowers will face a significant increase in their monthly mortgage payments. We project that the biggest increase in the number of 'financially stretched' borrowers will occur between July and September 2023.
- 1.5 Given this, and the number of consumers affected, we are introducing changes to our Handbook without consultation, to support the implementation of the commitments made under the new Mortgage Charter.
- 1.6 We are amending our responsible lending rules (MCOB 11.6). These changes mean lenders do not need to undertake an affordability assessment when varying a contract to allow a customer to make reduced capital payments (including to zero, and paying interest only) for up to 6 months, or when reversing a term extension within 6 months of it taking effect.
- 1.7 These are limited exemptions from our affordability requirements. Lenders will still need to assess affordability if a borrower wants to permanently convert to an interest-only mortgage or to extend the term of their mortgage beyond their expected retirement date.
- 1.8 Where these options are used, both the overall cost of the mortgage and the borrower's monthly payments are likely to be higher than they would otherwise have been. Where borrowers are confident they can continue to meet their original contractual mortgage payment, they should continue to do so.
- 1.9 We will update FG23/2 to reflect these new options as soon as possible.

Who this affects

- 1.10 This policy statement applies to:
- mortgage lenders and administrators
 - home purchase providers and administrators
- 1.11 It may also be of interest to:
- industry groups and trade bodies
 - credit reference agencies
 - consumer groups
 - individual customers

Our rule-making powers

- 1.12 We are using general rule-making powers in section 137A of the Financial Services and Market Act 2000 (FSMA) to introduce these sourcebook changes. We need to make these changes now to reduce the likely consumer harm if we delayed implementation by consulting. Under section 138L of FSMA, we are not required to conduct a public consultation on rule changes if we consider the delay this would involve would be prejudicial to the interest of consumers.
- 1.13 We are satisfied that this test is met, given the imminent expiry of many low fixed rate mortgages, rising interest rates and continuing cost of living pressures. 893,000 fixed-rate deals expire this year alone, and rates have risen significantly across the market. We recognise that signatories of the Mortgage Charter want to deliver support quickly and we are therefore acting at pace to deliver the changes required to support this. These measures are permissive, and making these changes now is necessary to provide certainty and clarity for lenders wishing to further support their borrowers, and for borrowers looking to know what options they may have when making decisions about their mortgage.

How it links to our objectives

Consumer protection

- 1.14 The changes we are making will advance our objective to secure an appropriate degree of protection for consumers by enabling lenders to offer their customers swift, temporary reductions in payments and for customers to make an informed choice on their options. Firms will need to ensure they give customers sufficient information to support their decision to use one of these options, where it is offered.

What we are changing

- 1.15 We are introducing changes to our Handbook to enable firms to allow mortgage borrowers to:
- reduce their capital repayments (including to zero, and paying interest only) for up to 6 months
 - fully or partly reverse a term extension within 6 months of extending the term
- Lenders may now offer both these options without a new affordability assessment.

Outcome we are seeking

- 1.16 The new options outlined in this statement will allow residential mortgage lenders to offer all borrowers (except for second charge and bridging loan customers) a temporary, contractual reduction in their monthly mortgage costs without an affordability assessment. It thereby enables a key commitment made under the Mortgage Charter.
- 1.17 We expect lenders to help borrowers to make informed choices when considering the support they may need. Lenders should make clear the potential costs and risks of changing a mortgage contract.
- 1.18 Borrowers taking up these options should be prepared for higher monthly payments after the temporary period is over, and higher overall costs over the term of their mortgage.
- 1.19 Where borrowers are confident they can continue to meet their original contractual mortgage payment, they should continue to do so. This is because borrowers who do not make changes to their mortgage payments will pay less interest overall.

Measuring success

- 1.20 As part of our supervision of firms, we will engage with them and request data to assess how they are making use of these changes, and the outcomes for customers. In due course we will consider whether any updates are required to firms' regulatory reporting.

Equality and diversity considerations

- 1.21 We have considered the equality and diversity issues that may arise from the Handbook changes in this Policy Statement.

Overall, we do not consider the Handbook changes materially impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the changes and will revisit them as part of our review of the impact of the new rules.

Next steps

- 1.22 The rule changes take effect from 30 June 2023. Firms may begin using these exemptions from that date.
- 1.23 We will review the impact of the rule changes within 12 months.

2 Handbook changes

- 2.1 The purpose of these changes is to enable, as simply and clearly as possible, firms that have signed up to the Government's Mortgage Charter to deliver on the commitments it contains. However, our approach does not limit the effect of our changes to those firms alone. These changes will allow any authorised mortgage lender to offer first charge residential mortgage borrowers the option to temporarily reduce their contractual payments, without an affordability assessment (usually required under MCOB 11.6.2R) or creating a payment shortfall, and to reverse a recent extension to their mortgage term.

Variations to mortgage contracts

- 2.2 Lenders can use existing flexibility in our rules to allow borrowers to extend their mortgage term up to retirement without assessing affordability. Previously, if the borrower wanted to return to their original term, their lender would generally have needed to assess if the increased monthly payment would be affordable before proceeding. They will now be able to do so without an affordability assessment, as long as the borrower decides to reverse the extension within 6 months of the term extension having taken effect. This change also applies with respect to regulated home purchase plans.
- 2.3 Lenders will also be able to offer borrowers a way to temporarily reduce their capital payments, with the option of making interest-only payments for up to 6 months. After this agreed period, they will be expected to resume full capital repayments, including making up for the reduced payments over the remaining term of the mortgage.
- 2.4 A borrower reducing their capital repayments or extending their term (even if they later reduce it) will increase the overall cost of their mortgage. Their monthly payments will also increase once the temporary interest-only period ends, and if they revert to their original mortgage term.
- 2.5 These rules are exemptions from responsible lending requirements. They are not mandatory, but any lender may use them, subject to the limitations set out below. Lenders who have signed up to the Mortgage Charter may make use of them to fulfil those commitments.
- 2.6 Our rule changes have not superseded or replaced any of the existing forbearance options within MCOB 13. Lenders will still be expected to consider appropriate forbearance arrangements for borrowers in financial difficulty. This is particularly the case given the signatories' commitment not to repossess within 12 months of a missed payment except in exceptional circumstances. This commitment is in line with the approach to repossessions in the Pre-action Protocol and MCOB 13 - namely that lenders must not repossess the property unless all other reasonable attempts to resolve the position have failed.

Scope of the changes

- 2.7 These changes only apply to first charge residential mortgages and (for term reductions) home purchase plans. They do not apply to bridging loans or second charge mortgages. We have limited the effect of these changes because the immediate concern, and scope of the Charter, has been the mainstream mortgage market. We will consider the case for extending the rule changes beyond first charge residential mortgages and home purchase plans (for example, second charge and bridging loans) as part of our review.

Changes to enable term reduction

- 2.8 The change contained in MCOB 11.6.3R(3)(b) permits a lender to reverse a term extension, within 6 months of it taking effect, either partially or to the original term length. For example, where a borrower has 10 years remaining on their mortgage and their lender allows them to extend the term to 15 years, if they choose to revert back to the original mortgage term after 6 months, the remaining term of the mortgage would be 9 years and 6 months. The 'Example illustrations of impact of changes' below sets out how this may take effect.
- 2.9 New MCOB 11.6.3R(5) provides that a borrower cannot make repeat use of this option. A borrower does not have to revert their term back to its original length if they do not want to, but if they want to revert without an affordability test, this must be done within 6 months of extending their term.
- 2.10 Where a borrower chooses not to revert their term to its original length, their monthly payments will remain at the lower rate, with a higher overall cost across the term of the mortgage. These borrowers are likely to still have options to reduce their term if they want to. They may be able to make overpayments, which are likely to be penalty-free as long as the overpayment is within any early repayment charge limits on their mortgage. This would have the effect of reducing the term without an affordability assessment being required, and would give them flexibility to increase payments as and when their financial circumstances improve. Borrowers may also reduce their term through another contract variation or new mortgage contract, which would likely involve an affordability assessment.
- 2.11 As is currently the case, a term extending into (or further into) retirement is likely to be material to affordability (see MCOB 11.6.4E), in which case an affordability assessment would be required.

Changes to enable a temporary interest-only period

- 2.12 New MCOB 11.6.3R(3)(a) exempts lenders from the requirement to undertake an affordability assessment for a contract variation which temporarily reduces the capital repayments required under a repayment mortgage for no more than 6 months. Such a variation could reduce the capital repayments due for this period to zero, meaning the borrower would be required to make payments of interest only. This new flexibility will only be permitted if the mortgage remains on a repayment basis (new MCOB 11.6.3R(4)). That is to say, it will only be possible if the borrower will return to making payments of capital and interest following the temporary reduction. Ultimately, the borrower will have to repay the whole capital balance outstanding over the remainder of the term (unlike with permanent interest-only

mortgages where the borrower repays the capital at the end of the mortgage term). Typically, this will mean the borrower's payments will be higher after the limited interest-only period expires.

- 2.13 New MCOB 11.6.41R(4) also exempts this type of variation from the requirement to assess whether the borrower has in place a credible and clearly understood strategy for repaying the capital at the end of the mortgage term. This requirement is not necessary as the mortgage will remain a repayment mortgage with the borrower expected to make regular repayments of capital and interest (after the expiry of the limited interest-only period). Given this exemption, other provisions which deal with repayment strategies (such as MCOB 11.6.46E) naturally do not apply.
- 2.14 For clarity, these changes do not apply to a variation to an interest-only mortgage followed by a second variation back to a repayment mortgage. They only apply to a single variation which reduces capital payments for a temporary period, with full repayment of capital required after this time. Under these changes no shortfall will arise and no capitalisation will occur – payments of capital are simply reallocated across the remaining term.

Example illustrations of impact of changes

The following illustrations show how using one of these new options would affect a borrower with an outstanding balance of £100,000, paying interest of 6% and with 10 years remaining on their contract.

Reversal of term extension

Payments before extension: £1110

Payments following 10-year term extension: £716

Payments following reversal of extension after 6 months: £1138

This borrower defers approximately £2400 over the 6 months their term was extended, which still remains payable once their term reverts. Assuming their interest rate remains at 6% for the remainder of their term, they will pay around £800 more overall than if they had kept their term constant.

Temporary interest-only

Payments before temporarily paying interest-only: £1110

Payments while temporarily paying interest-only: £500

Payments after end of temporarily paying interest-only: £1153

This borrower defers approximately £3720 over the 6 months of the interest-only period, which as above remains payable over the rest of their term. Assuming their interest rate remains at 6% for the remainder of their term, they will pay around £1200 more overall than if they had continued to make capital payments.

Temporary interest-only combined with term extension

In this example we assume that the borrower agrees with their lender a term extension of 6 months as well as a temporary switch to interest-only, to avoid an increase in monthly payments following the change.

Payments before temporarily paying interest only: £1110

Payments while temporarily paying interest only: £500

Payments after temporarily paying interest only: £1110

This borrower defers around £3720 over the 6 months of the interest-only period, which still remains payable over the rest of their term. Assuming their interest rate remains at 6% for the remainder of their term, they will pay around £3000 more overall than if they had continued to make capital payments and not extended their term.

Disclosure to customers

- 2.15 Before agreeing either option, firms will need to give borrowers a personalised disclosure outlining the specific changes to the borrower's amounts due, including where it is known that the payment will change, the new payment and the date of the change in accordance with existing rules (MCOB 7.6.28R). Firms will also need to meet expectations set under the Consumer Duty's 'consumer understanding' outcome. Firms will need to make sure customers understand the features, costs, and benefits of the option they choose, before the change takes effect.
- 2.16 Where a customer is considering a temporary interest-only period, firms will need to disclose both the initial reduced payment amount and what the subsequent higher payments will be when the contract reverts to a full repayment basis.
- 2.17 We do not consider that MCOB 7.6.28R(5) applies to the new rule for temporary interest-only. This is because, for the purposes of MCOB 7, a temporary switch to interest-only does not convert the contract type of the mortgage to interest-only. This means it remains a repayment mortgage contract and this provision would not apply.
- 2.18 Similarly, we do not consider MCOB 7.6.28AR relevant where firms reallocate the payments rather than creating a payment shortfall, as there would be no capitalisation of any sums due.

Execution-only sales

- 2.19 To meet the commitments in the Government's Mortgage Charter, we anticipate that firms will offer these contractual variations on an execution-only basis, and that they will use digital tools where possible.
- 2.20 Execution-only contract variations are permissible under our rules (MCOB 4.8A.10R). This is provided they do not involve additional borrowing and, where the change

includes a rate switch, the customer is presented (via a non-interactive channel) with all products offered by the firm for which the customer is eligible.

- 2.21 In such a case, borrowers will not receive advice on the suitability of these changes with respect to their personal circumstances. Instead, personalised disclosure (complying with the requirements set out above) should ensure customers can make informed choices.

Consumer Duty

- 2.22 When offering these new options, our Consumer Duty will apply. For new and existing products or services that are open to sale or renewal, the Consumer Duty will come into force on 31 July 2023. For closed products or services, the Duty will apply from 31 July 2024.
- 2.23 The Consumer Principle, Principle 12, requires firms to 'act to deliver good outcomes for retail customers'.
- 2.24 Principles 6 and 7, and customer's best interests (MCOB 2.5A.1R) apply to all firms and products, including closed mortgage books.
- 2.25 We want firms to support their borrowers make informed decisions about financial products and services. When offering these new options, firms must aid their customers understanding of them, in addition to any other options they may also provide. Firms should present information in a way that properly explains the benefits and risks, and prominently highlights the key costs that may be incurred.
- 2.26 Firms should make clear to borrowers seeking to use these options:
- the potential costs and risks associated with them
 - that their affordability for the new payment schedule has not been assessed
 - if the borrower can meet their current payments they should continue to do so
- 2.27 Firms must avoid causing foreseeable harm to customers. The firm should take steps to ensure that customers understand the risks and consequences of their choices. Even where firms act reasonably to meet the Duty, consumers may sometimes make poor decisions. If a customer insists on a course of action that the firm regards as harmful, they are not obliged to prevent it.

Exit from temporary interest-only period

- 2.28 Borrowers who cannot afford their current monthly payments and temporarily switch to interest-only may be unable to afford payments at an increased level after the 6-month period. Lenders should ensure they are ready to provide appropriate support to borrowers in this position.

Annex 1 Abbreviations used in this paper

CEO	Chief Executive Officer
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
MCOB	Mortgages and Home Finance: Conduct of Business
TSG	Tailored Support Guidance

Annex 2 Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).
2. When making rules, the FCA is required by section 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA must also consider whether rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.
4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of His Majesty's Government to which we should have regard in connection with our general duties.

The FCA's objectives and regulatory principles: Compatibility statement

5. The rules described in this statement are primarily intended to advance the FCA's operational objective of consumer protection. They are also relevant to the FCA's market integrity objective.
6. We have had regard to each of the 8 matters listed in s.1C(2)(a)-(h) in FSMA. Provided that those lenders who choose to use the options outlined above communicate the risks and implications of these effectively to their borrowers, including through the required disclosure and in line with the Consumer Duty, consumers are likely to be able to make their own judgement on what options, if any, they need. We understand that there are differing degrees of understanding from consumers, and that they must take responsibility for their decisions. We believe the changes set out do not change this.
7. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because the changes are permissive but will allow lenders to offer swift temporary reductions in their monthly payments and customers to make an informed choice on their options. Lenders can still form their own risk appetite and decide what options and support to offer customers – our rules provide an exemption from certain tests where this can help borrowers. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by s. 1F FSMA.

The need to use our resources in the most efficient and economic way

8. We have considered our approach as the most efficient and economic way of fulfilling our commitment to support the implementation of the Mortgage Charter. If we did not adopt this approach, the alternative option of a series of waivers and modification of rules would be more resource-intensive and less efficient.

The principle that a burden or restriction should be proportionate to the benefits

9. We have not imposed any new requirements on firms, any additional burden is up at their discretion. We have also taken into account the importance of appropriate disclosure to enable informed customer decisions. Where firms choose to offer the support made available through our changes, it can be beneficial for consumers, as outlined above.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

10. We have had regard to this principle and do not believe that our measures undermine it.

The general principle that consumers should take responsibility for their decisions

11. We have had regard to this principle and do not believe that our measures undermine it. Signatory firms will be expected to provide the appropriate information to consumers about the support they may want, and a consumer must still take responsibility for the option they choose.

The responsibilities of senior management

12. We have had regard to this principle and do not believe that our measures undermine it.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

We have had regard to this principle and do not believe that our measures undermine it.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

13. We have had regard to this principle and do not believe that our measures undermine it.

The principle that we should exercise of our functions as transparently as possible

14. Rules made using s137L, without prior consultation or full cost benefit analysis do not undergo the usual process of testing draft rules and receiving feedback from the public before they are made. However, in the context of moving to swiftly introduce rule changes to support the Mortgage Charter we have sought to be as transparent through the publication of this Policy Statement. As set out in the Policy Statement, we felt delay would be prejudicial to the interests of consumers.
15. We have consulted industry representatives, HM Treasury and the Prudential Regulation Authority on our changes, to mitigate against unintended consequences.

16. In formulating these measures, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA).

Expected effect on mutual societies

17. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

Compatibility with the duty to promote effective competition in the interests of consumers

18. We consider our rules to be consistent with the FCA's duty to promote effective competition in the interests of consumers.

Equality and diversity

19. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraph [1.20] of the Policy Statement.

Appendix 1 Made rules (legal instrument)

MORTGAGE AFFORDABILITY RULES (AMENDMENT) INSTRUMENT 2023

Powers exercised

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (General rule-making power); and
 - (2) section 137T (General supplementary powers).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 30 June 2023.

Amendments to the Handbook

- D. The Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Mortgage Affordability Rules (Amendment) Instrument 2023.

By order of the Board
29 June 2023

Annex

Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

In this Annex, underlining indicates new text and striking through indicates deleted text.

11 Responsible lending, and responsible financing of home purchase plans

...

11.6 Responsible lending and financing

...

The assessment of affordability

...

11.6.3 R ...

- (3) *MCOB 11.6.2R does not apply to a variation to the terms of a regulated mortgage contract or home purchase plan which:*
- (a) reduces (including to zero) the capital repayments required under a repayment mortgage for a period of no longer than six months;
 - (b) reverses (in full or in part) a term extension within six months of it taking effect; or
 - (c) is made solely for the purposes of forbearance where the customer has a *payment shortfall*, or in order to avoid a *payment shortfall*.
- (4) Paragraph (3)(a) only applies where the contract:
- (a) remains a repayment mortgage after the variation (because the mortgage is still designed to be repaid in full over its term);
 - (b) has not previously been varied in reliance on that paragraph; and
 - (c) is not a bridging loan or a second charge regulated mortgage contract.
- (5) Paragraph (3)(b) only applies where the contract:

- (a) has not previously been varied in reliance on that paragraph;
and
- (b) is not a *bridging loan* or a *second charge regulated mortgage contract*.

...

Entering into interest-only mortgages

- 11.6.41 R (1) *A mortgage lender may only enter into an interest-only mortgage, or switch a repayment mortgage onto an interest-only basis for all or part of its term, if:*

...

- (4) Paragraph (1) does not apply in respect of a variation to the terms of a *regulated mortgage contract* made in accordance with *MCOB 11.6.3R(3)(a)*.

...

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