Financial Conduct Authority

# John's story

## Background

- John has a repayment mortgage of £200,000 with XYZ Building Society. He had an interest rate of 3% per annum and was paying £1,109 per month.
- John suffered payment difficulties with his mortgage and fell into payment shortfall (commonly known as arrears). The arrears built up to £5,000.
- John overcame the cause of his payment difficulties. He spoke to his lender about repaying the arrears. Based on his income and expenditure, John could afford to pay an additional £208 per month to clear the arrears. This meant John entered into an arrangement to pay (ATP) of £208 per month in addition to his monthly mortgage payment of £1,109 (total £1,317 per month).

## The situation

John's interest rate of 3% came to an end. John moved to the lender's standard variable rate, which was 3.25%. The change in rate triggered the lender's system to automatically calculate John's new monthly repayment to ensure that John's monthly payments remained on track to repay his mortgage by the end of the term.

OUTCOME 1

### What actually happened:

The lender automatically **included** the arrears balance in the calculation, which meant that the new monthly payment of £1,185 included an element that would repay the arrears.

The lender continued to treat the arrears balance as immediately payable and continued to collect an additional amount each month from John through the ATP.

As John could still only afford to pay a total of £1,317 per month, he contacted his lender and agreed a new ATP of £132 per month on top of the new monthly payment of £1,185.

This meant that John was paying £132 per month towards the arrears despite the fact that the new higher monthly payment had already taken this into account.

John continued to meet most of his ATP payments and the arrears was cleared in just over 3 years. Once cleared, John's ATP stopped but he was required to continue paying £1,185 per month.

OUTCOME 2

### What should have happened:

The lender should have calculated the new monthly payment **excluding** the arrears balance. This would have meant the monthly payment would only have increased to £1,155.

The lender would continue to treat the arrears balance as outstanding and collect an additional amount each month from John through the ATP.

Based on John's affordability of £1,317 per month, this would have meant a new ATP of £162 per month that he would have paid towards the arrears balance.

The arrears would have been cleared sooner in just over 2.5 years. Once cleared, John's ATP would stop, leaving only his payments of £1,155 per month.

## Result – the impact of Outcome 1 vs Outcome 2

**IMPACT OF OUTCOME 1**

- £1,185 monthly mortgage payment
- £132 per month towards arrears
- Arrears balance cleared in just over 3 years
- Credit reference agency file shows as being in arrears for just over 3 years

**IMPACT OF OUTCOME 2**

- £1,155 monthly mortgage payment
- £162 per month towards arrears
- Arrears balance cleared in just over 2.5 years
- Credit reference agency file shows as being in arrears for just over 2.5 years

**− of Outcome 1 compared to Outcome 2**

- **John's arrears took longer to clear.**
- **His credit reference agency records may be mis-stated.**
- **John's payments lacked clarity.**
- **He made overpayments to his mortgage balance without knowing or intending to.**
- **John may have paid additional fees and charges.**

**+ of Outcome 2 compared to Outcome 1**

- **John's arrears would have been repaid more quickly.**
- **He would have had clarity on what he was paying to arrears.**
- **When John paid off the arrears his total monthly payments would have been lower.**
- **He may have paid less fees and charges.**

### Effects of overpayments

In Outcome 1 an element of John's monthly payment of £1,185 included repayment of the arrears balance: this meant he was making overpayments towards his mortgage balance. If John continues to meet all his mortgage payments, and there are no further calculations to his mortgage payment, he will repay his mortgage earlier than the original mortgage term. If there is a further calculation, his new mortgage payment would reflect any overpayments he made, and his mortgage would remain on track to be repaid at the end of the original mortgage term.

If John had known he was making overpayments, he might have chosen to spend that money on something else (for example, other debts). This means he may have suffered a further financial disadvantage as a result of the way his mortgage payments were calculated.

### Compensation

John may be entitled to a compensation payment, the sum involved will depend on the remediation approach adopted by his lender. We are consulting on a remediation framework which is one approach firms could take.

THIS EXAMPLE IS FOR ILLUSTRATIVE PURPOSES ONLY AND MAY NOT REFLECT ACTUAL AMOUNTS PAID BY CUSTOMERS OR LENDERS' ACTUAL PRACTICES (FOR EXAMPLE, LENDERS MAY NOT ALWAYS RECALCULATE THE CUSTOMER'S TOTAL AFFORDABILITY FOLLOWING A MONTHLY MORTGAGE PAYMENT INCREASE).