Financial Conduct Authority

Summary of feedback received

August 2013

Consultation title	Dealing fairly with interest-only mortgage customers who risk being unable to repay their loan.
Date of consultation	2 May 2013 – 3 June 2013
Summary of feedback received	We received nine responses to our guidance consultation paper from a range of respondents, including firms, consumers, consumer representatives, and trade associations on behalf of their members. Respondents were generally supportive of the guidance and agreed it provides helpful insight on what firms can do to help customers who may be unable to repay their loan at maturity. We are therefore not making significant changes to the guidance. We address the main points raised by respondents in this document. Where relevant, we have added some additional text to the guidance to clarify our views. We received some opposing views on a number of points and as a result we have, where possible, provided the FCA view on those points. We have addressed the main points in the order provided in the guidance paper. In terms of volume of responses, the main points raised related to: - MCOB 11.8.1E (section 2) - MCOB 13 (section 4) - Options available (section 3)
Response to feedback received	**1. Executive summary** No comments received.

2. Guidance summary

MCOB 11.8.1E[1]

We received a number of responses asking for clarity around the Mortgage Market Review (MMR) evidential provision for 'trapped' customers, and how this works in practice, including whether existing customers should be offered the same choice of rates as new customers.

This evidential provision is designed to protect customers who are unable to enter into a new mortgage (whether with their current lender or another lender), or vary the terms of their existing mortgage. It does not require all customers to be treated the same because we recognise that customer characteristics vary. Mortgage products available to customers vary according to various factors that firms use to determine risk-based pricing, such as loan-to-value or credit history. Firms are not obliged to offer existing customers the same rates as new customers.

An example of unfair treatment is charging 'trapped' borrowers a higher rate to exploit the fact that they are unable to exit the mortgage. We will expect firms to be able to demonstrate to us how they have complied with Principle 6 in their treatment of 'trapped' customers, for example by being able to show the basis for risk-based pricing, which may affect them more than customers who are not 'trapped'.

Part interest-only/part capital repayment

We received feedback which suggested the guidance needs to be clear that interest-only (IO) includes those mortgages on part IO/part repayment and this has now been included.

Mortgage intermediaries

One respondent indicated this guidance will also be of interest to mortgage intermediaries as customers are likely to contact them if they arranged the IO mortgage. This has now been included.

Requirement on firms

One respondent suggested complying with the guidance should be a requirement and not an option.

The issuing of guidance is to help firms understand how they can comply with a specific rule or requirement, in this case how firms can act in line with Principle 6[2] when dealing with existing IO mortgage customers. Based on the findings of our thematic

[1] MCOB 11.8.1E states 'where a customer is unable to: (1) enter into a new regulated mortgage contract or home purchase plan or vary the terms of an existing regulated mortgage contract or home purchase plan with the existing mortgage lender or home purchase provider; or (2) enter into a new regulated mortgage contract or home purchase plan with a new mortgage lender or home purchase provider; the existing mortgage lender or home purchase provider should not (for example, by offering less favourable interest rates or other terms) take advantage of the customer's situation or treat the customer any less favourably than it would treat other customers with similar characteristics. To do so may be relied on as tending to show contravention of Principle 6 (Customers' interests).

[2] Principle 6 of the FCA's Principles for Business states that 'a firm must pay due regard to the interests of its customers and treat them fairly'.

work, we continue to feel that guidance is the most appropriate response and allows us to provide an early steer to firms. However, we will continue to monitor the issue.

Publishing information and data
Some respondents suggested firms should publish details of their written strategies and management information relating to their IO back book including reports on progress.

Firms can publish this data if they wish but it is not a requirement.

3. Guidance for consultation

Governance

Options available
Respondents expressed a range of views in relation to firms offering existing interest-only mortgage customers new mortgage products. Some raised concerns that firms could use this as a sales opportunity to move customers onto more expensive products such as equity release. Others suggested equity release should be promoted as a potential solution.

We recognise that for a select group of customers, equity release may provide an alternative solution to repaying the existing mortgage when other solutions are not available. However, this will not be the case for all customers, and will depend on their individual circumstances.

Other responses suggested firms should offer lower rates to existing interest-only customers, with some suggesting that any resulting monthly payment reduction should be used towards capital repayment through a full or partial switch to a repayment mortgage.

Firms are not obliged to offer lower rates to these customers. However, they may be able to offer flexible solutions to help them. For example, where firms are able to offer their customers a standard product transfer that results in a reduced monthly payment, and allows the customer to use the subsequent savings towards reducing the capital outstanding, then we regard this as a positive outcome for the customer, as it may help to improve their situation.

Where firms are providing special terms to a customer (for example, offering a reduced rate that is not part of their standard range available to all existing customers), then this would be considered an impairment event, and as a result firms will need to consider the necessary requirements associated with that such as reporting, assessment of associated future cash flows and assessment of expected loss risks.

A number of alternative options were also put forward. We already comment in section 3.5 that the list of options provided is not exhaustive and firms can offer other options to abide by Principle 6. Therefore we do not intend to add to this list.

Term extensions and age limitations
We received varied responses regarding term extensions with concerns raised that extending the mortgage term on an IO basis may further compound the issue for customers, while others suggested as long as the customer can afford the monthly payment, lenders should allow indefinite term extensions.

In some cases, term extensions will take customers into retirement. Where the customer's retirement income is sufficient to sustain the mortgage repayments indefinitely, and where there is a credible strategy in place to repay the loan (either at the end of the revised term or on death of the income earner(s), then an extended mortgage term may be a sustainable option. But we do not believe that providing mortgages on terms that are likely to be non-sustainable leading to possible customer detriment represent responsible lending.

Further concerns were raised that firms are limiting options available to customers by not allowing term extensions beyond the firm's maximum age policy.

Our conduct of business rules do not require lenders to set age limits for mortgages, and do not prevent lending to older customers: whatever the age of the borrower, affordability is the key consideration.

Firms are reminded that they will need to consider the requirements of the Equality Act 2010 in relation to age discrimination.

Firms restricting options they offer customers
Concerns were raised that firms would offer limited or no options to customers.

Lenders do have the right to expect the mortgage to be repaid as agreed. We cannot require firms through our guidance to offer specific options at maturity. However, if firms are unable to offer certain options, such as term extensions, then this will need to be communicated to customers in good time to allow them to consider the options which are available to them. Under Principle 6, firms will need to be able to demonstrate to the FCA reasons why certain options are not being offered and how they are treating customers fairly.

What constitutes 'enough time'
Some respondents requested clarification on what the FCA regards as providing customers with 'enough time' to consider options available to them. We have added in some examples in section 3.8 of the guidance.

Unnecessary obstacles including fees

Respondents expressed differing views on the position of fees/charges and whether these should be waived for existing IO customers.

Having given this further consideration, our view is that it is not unfair if firms charge a reasonable fee to cover their costs, but we would be concerned if fees/charges were acting as a barrier to customers finding solutions. Firms may consider waiving fees or look at other options to help remove this potential barrier for customers.

Another obstacle highlighted by a respondent included a firm that had outsourced the administration of mortgage accounts to a third party with no power/ability to vary the terms of the loan.

As highlighted in Section 3.10 of the guidance, firms are expected to have in place written guidance for front-line staff, including any third-party administrators. Firms must also have in place sufficient monitoring to ensure staff and third parties are adhering to the firm's policy and we detail this in section 3.14 of the guidance.

Documented guidance framework

Assessing affordability
Some respondents felt that there should be rigorous affordability assessments with a suggestion that the Common Financial Statement (which is used for assessing debt) should be used by all firms. Others suggested affordability should be in line with the MMR requirements to ensure a consistent approach.

The guidance already indicates firms should be assessing a customer's ability to afford the revised regulated mortgage contract in line with its written policy (Section 3.15). We have included a new section on post-MMR considerations in the guidance (Section 5) and ensured consistent wording around affordability.

Firms should consider other alternatives where affordability means an option cannot be offered. For example, if transferring to a capital repayment mortgage would not be sustainable due to long term affordability but the customer wishes to pay more each month, firms could consider accepting overpayments instead. This is likely to put customers in a better position than not taking any action.

Staff / Training / Use of financial (or other) incentives
Respondents requested clarification on 'dedicated staff' and what training should be given. Concerns were also raised that financial or other incentives could be used to encourage staff to offload unprofitable customers or switch customers to unsuitable alternatives.

We have recently published finalised guidance on risks to customers from financial incentives and we expect firms to be mindful of that guidance. Further clarification on staff and training is now included in Section 3.13 of the guidance.

Customers in arrears
One of the respondents suggested that customers in arrears should receive an immediate review of their maturity options.

While firms engage with customers in arrears, the main focus will be to resolve monthly payment difficulties. Therefore, it may be more appropriate to discuss maturity options once this has been achieved.

Management information

No points raised.

Customer communications

Verification of repayment strategies
Respondents expressed a range of views about how lenders should verify repayment strategies. Some suggested that lenders should accept verbal confirmation of the repayment strategy from customers, whereas others suggested lenders should fully verify whether the customer is saving enough into a repayment strategy.

Our view is that it is the customer's responsibility to ensure they are saving enough and are on track to repay the capital at maturity. Lenders' requests for information should be balanced and proportionate and we have included this in examples of good/poor practice under customer communications.

Assessing 'doubt' about customer's ability to repay the capital
One response requested a practical example of how a firm could assess whether there was 'doubt' about a customer's ability to repay the capital.

We would suggest a firm may have doubt if it is not aware of what the customer's repayment strategy is, and/or where its credit-risk profiling indicates a possible shortfall.

Warnings of long-term consequences
Some respondents said that the longer-term consequences of non-repayment of the capital should be detailed in communications to customers.

The guidance already sets out in Section 3.24 and good/poor practice that communications should provide a balanced position and include any potential risk of not taking action. Therefore we do not intend to include anything further on this. A balanced positioning of the risks is important as we do not want to create a barrier to customer engagement.

Clearly-worded communications
One of the respondents suggested all correspondence should be

simplified, using plain English with clear contact details. Firms are required to comply with Principle 7[3] in their communications with clients. We have clarified in Section 3.25 of the guidance that we expect communications to be clearly worded.

Communication strategy
Some respondents suggested communication strategies should be targeted to specific groups of customers based on risk.

Firms may consider a risk-based approach when developing their communication strategy to ensure the highest risk customers are prioritised and this is detailed in Section 3.26 of the guidance.

Testing different forms and formats of communication
One respondent suggested the FCA should work with lenders to test different formats of written communications to monitor the impact on customer behaviour.

We recently published our papers on applying behavioural economics and encouraging customers to claim redress, in which we encourage firms to consider when developing their communication strategies. We will continue to engage with the industry on this.

Monitoring of follow-up telephone campaigns
Our examples of good/poor practice includes communication strategies that are supported by follow-up telephone campaigns. One respondent highlighted that follow-up campaigns should be monitored to ensure frequency of calls are reasonable and do not constitute harassment.

We have already indicated in Section 3.14 of the guidance that firms should have sufficient monitoring in place to ensure customers are being dealt with fairly and consistently and this would include any follow-up campaigns.

Sign post to free advice in communications
A number of responses suggested communications should include sign posts to free advice.

We have already included this in the guidance under examples of good practice.

4. Application of existing rules and guidance

MCOB 13: Arrears and repossessions

Further clarification was sought around which parts of MCOB 13 specifically apply to post-maturity loans.

[3] Principle 7 of the FCA's Principles for Business states that 'a firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading'.

We have included further details of this within section 4.5 of the guidance. As we indicate in the guidance, firms are not bound by MCOB 13 requirements in their approach to interest-only customers reaching maturity. However, we recognise the positive treatment of customers achieved by firms voluntarily aligning their approach with MCOB 13.

Another respondent would like our current MCOB 13 rules to be extended to include post-maturity customers, at least on a transitional basis for the next 2 years, to protect customers with more immediate maturities who have not benefitted from early communications.

We do not intend to do this, but we have included some further clarification around providing enough time to customers in section 3.8 of the guidance. This highlights that firms may wish to consider whether to offer more options to those customers who have not benefitted from early communications, or provide more time to take action if no or limited post-maturity options are available.

MCOB 8 and MCOB 9: Equity release

Some respondents requested clarification of the FCA's view on situations where a term extension would constitute a lifetime mortgage.

We have included some further information on this in section 4.8 of the guidance.

5. Application of this guidance following implementation of the Mortgage Market Review (new section)

We were asked to provide details of the post-MMR impact for completeness. This is now included under Section 5.

6. Considerations regarding mortgage contracts (previously Section 5)

Further clarification was sought on the circumstances where a failure by the party not in breach to act at maturity could limit the way that party is able to behave, as it was felt this could potentially contradict lenders' pre-existing contract terms.

In Section 6.1 of the guidance we indicate the terms and conditions (T&Cs) will generally continue until the loan is repaid. We believe protection of firms' legal rights is a matter for firms themselves to consider, based on their own T&Cs and the facts and circumstances of the particular case.

Annex 1: Changing a contract – Unfair terms considerations
No comments received.

Annex 2: Prudential forbearance, reporting and provisioning for non-repayment of the capital balance at the term end

One response suggested guidance was required on the prudential requirements when information gathered by lenders during the term of the mortgage suggested there was no repayment strategy in place or there was estimated to be a significant shortfall. This has now been included under Annex 2 of the guidance.

Annex 3: Cost benefit analysis

We received one response on our cost benefit analysis, which included the following comments:

- the potential overall cost to lenders in ensuring their strategy will cause the borrower to act is an unknown factor at this stage
- how much an 'increased engagement with customers' will add to handling the IO back book is uncertain
- there is other expenditure incurred by the ongoing regulatory change to which these additional costs will be added so while the additional costs of this activity may be small in isolation, they add to the increased overall regulatory burden
- although there is an identification of the costs and benefits, there is no attempt to actually value them

When we are assessing new policies/guidance, we look at the marginal impacts rather than the overall regulatory burden. As this is guidance on rules (including principles), we will only quantify costs where they are likely to be significant, and we do not believe they will be in this case. This is because firms will have to deal with the maturity of IO mortgages, and treat their customers fairly, regardless of any guidance we make. This guidance provides additional clarity and options on how to do this.

It remains up to firms to decide the correct level of communication with customers, so the costs of appropriate customer engagement, that meets our principles, is unlikely to change significantly by making this guidance. As such we confirm our original cost-benefit analysis: we do not expect the incremental costs to be large and think the benefits likely to outweigh these costs.

Other comments received

Ongoing monitoring

One respondent suggested that given the level of risk and potential detriment to customers, the FCA will need to monitor this issue to ensure firms are treating customers fairly and to measure performance of firms.

As with all risks, maturity risk of existing IO mortgages will

	continue to be monitored within our regulatory framework. *FCA to remain alert to evidence of mis-selling* One respondent hoped the FCA will use the attention that our research has attracted to remain alert to evidence of mis-selling. Our study does not suggest there has been large scale poor practice in respect of the sale of IO mortgages. The vast majority of customers understood the product they were sold, understand the need to repay the mortgage balance and have plans, albeit in some circumstances imperfect, about how to repay. While it is impossible to rule out some instances of poor practice, we are not currently planning further work into historic sales practices. Instead we are focused on encouraging lenders and customers to act now to mitigate potential future customer detriment. *FCA review of firms' policies* Section 1.3 of the guidance indicates we reviewed firms' strategies, policies and practices which covered approximately 40% of the UK IO residential mortgage market. We were asked whether the remaining 60% were asked to participate and if so, did they decline. The firms selected for the population reviewed were a broad representative of the market. No other firms were asked to participate other than the firms selected. *Use of basic universal criteria* One respondent suggested basic universal criteria for deciding on options should be defined and accepted across all firms. Lenders may be in different positions in regard to what options they can offer and therefore we are not prescriptive on what criteria should be used. Under Principle 6, firms will need to be able to demonstrate to the FCA reasons why certain options are not being offered and how they are treating customers fairly. *FCA approach* A number of respondents welcomed the FCA's collaborative approach to this issue.
Changes made to the guidance as a result of feedback received	We have considered the feedback and have made some relatively minor changes and clarification to the guidance as indicated above.

You can access the full text of the guidance consulted on here.