

Policy Statement

PS16/25

Home finance customers with a payment shortfall: minor Handbook changes and feedback to CP16/16



December 2016

Contents

Abbreviations used in this paper	3
1 Overview	5
2 Summary of feedback and our responses	7
Annex	
1 List of non-confidential respondents	11
Appendix	
1 Made rules (legal instrument)	12

In this Policy Statement we report on the main issues arising from Consultation Paper 16/16 (Minor Handbook changes related to mortgage borrowers with a payment shortfall) and publish the final rules.

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We have developed the policy in this underlying rules in the context of the existing UK and EU regulatory framework. We will keep the policy under review to assess whether any amendments will be required due to changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

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Abbreviations used in this paper

CBA	Cost benefit analysis
CMI	Contractual Monthly Instalment
CP	Consultation Paper
FSMA	Financial Services and Markets Act 2000
HPP	Home Purchase Plan
MCOB	Mortgage and Home Finance: Conduct of Business sourcebook
PS	Policy Statement

1. Overview

Introduction

- 1.1** In June 2016 we consulted on making minor amendments to our Handbook rules and guidance for firms which have customers who are experiencing a mortgage or Home Purchase Plan (HPP) payment shortfall. In general, respondents welcomed our proposed changes. In this Policy Statement (PS), we summarise the feedback we received and provide our response, indicating where we have adjusted the final rules and guidance to take respondents' views into account. The final rules and guidance will come into effect on 15 December 2016.

Who does this affect?

- 1.2** This PS will be of interest to any firm currently administering mortgages or HPPs and trade bodies for these firms. We would also expect interest from those who support the provision of these services.

Is this of interest to consumers?

- 1.3** This PS may be of interest to consumers who either have a mortgage or HPP, or anticipate getting one, as well as their representative groups. In particular, this PS will be of interest to consumers who have experienced, or are experiencing, payment difficulties with their mortgage or HPP.

Context

- 1.4** The rules in MCOB Chapter 12 are designed to ensure that firms do not impose unfair or excessive charges. In particular, MCOB 12.4.1BR sets out how we expect firms to deal with payments they receive from customers who are suffering a payment shortfall. The rule aims to ensure that firms handle payments in a way that minimises the time customers take to pay off the arrears, thus reducing the amount they pay in related fees and charges.
- 1.5** In Consultation Paper 16/16 we consulted on proposed changes to MCOB 12.4.1BR. These changes were to clarify that, when a customer is suffering a payment shortfall, the firm must ensure that no part of any payment received from the customer is allocated towards paying un-capitalised interest or charges incurred because of a payment shortfall before the balance of the payment shortfall has been cleared.

- 1.6** We also consulted on changes to the definition of payment shortfall in order to make it clear that interest (on missed payments), outstanding fees and charges, and ancillary items (such as unpaid service charges settled by the lender on behalf of one of its borrowers) do not form part of a payment shortfall.
- 1.7** The proposed changes did not result from a change of policy, and were designed to clarify our expectations and to ensure an appropriate level of consumer protection.

Summary of feedback and our response

- 1.8** In general, respondents welcomed our intention to clarify our Handbook provisions. However, some respondents raised issues about the effect of those clarifications, which they thought would lead to some firms needing to change their systems or processes even where they were consistent with our overall policy intent.
- 1.9** We have considered this feedback and, as a result, have amended the draft provisions in CP16/16. We consider the provisions now take into account the points made during the consultation while meeting the original policy intention.

Impact of changes on mutual societies

- 1.10** Section 138K of FSMA requires us to consider if our proposed rules have a significantly different impact on mutual societies when compared with other authorised persons.
- 1.11** In CP16/16 we asked for comments or information on any issues for mutual societies arising from our proposals. Our initial assessment in CP16/16 stated that, while our proposed amendments may impact mutual societies involved in mortgage lending, the impact on them would not be significantly different to that on other authorised persons. We did not receive any feedback during the consultation process to contradict this view.

Equality and diversity considerations

- 1.12** We are required under the Equality Act 2010 to consider whether our proposals could have a potentially discriminatory impact on groups with protected characteristics (age, gender, disability, race or ethnicity, pregnancy and maternity, religion, sexual orientation and gender reassignment). We are also required to be aware of the need to eliminate discrimination and support equality of opportunity when carrying out our activities.
- 1.13** We published our equality impact assessment in CP16/16 and invited comments or information about the potential impact of our proposals on equality and diversity issues. Our initial assessment was that our proposals will not create any equality and diversity issues and we did not receive any comments to contradict this view during the consultation process.

Next steps

What do you need to do next?

- 1.14** Firms should consider the clarifications made in the rules and guidance as an aid to ensuring that they comply with MCOB requirements, including the requirement to handle payments in a way that minimises the time a customer takes to pay off a payment shortfall.

2. Summary of feedback and our responses

- 2.1** In this chapter we outline the feedback we received to the Handbook changes we proposed in CP16/16 and set out our response.

Feedback

Q1: *Do you agree with our proposal to clarify MCOB 12.4.1BR and provide related Guidance?*

- 2.2** All respondents supported our policy that a lender should use payments they receive from a customer to clear any payment shortfall as quickly as possible. However, not all agreed that our proposed clarification of MCOB 12.4.1BR achieved this aim in the best way.
- 2.3** Some respondents considered that the amended rule was too prescriptive potentially making some existing practices non-compliant even though they met our policy objective. These respondents were concerned that firms would need to make costly systems changes to ensure compliance, but with no added consumer benefit.
- 2.4** Several respondents also commented on our proposed guidance to support the amended rule. While most respondents, including some firms, welcomed the additional clarification, others believed that clearer rule drafting would mean more detailed guidance wasn't needed.
- 2.5** One respondent argued that the rule should be constructed to make clear how payments should be allocated to a consumer's account rather than how they should not be applied.
- 2.6** One respondent thought that our rule should require firms to allocate payments to the contractual monthly instalment (CMI) before the payment shortfall, to prevent a customer with a mortgage split into sub-accounts from clearing a payment shortfall on one sub-account at the expense of another. Another respondent argued that fees and charges for arrears should not attract interest.

Our response:

We welcome respondents' support for our policy and we still believe that MCOB 12.4.1BR should be clarified. However, having considered responses to the consultation, we have amended our proposed rules and guidance to emphasise that, when considering the allocation of payments among (1) periodic instalment, (2) payment shortfall and (3) interest or charges resulting from that payment shortfall, a firm must ensure they allocate any payments they receive from a customer in a way that will minimise the amount of the payment shortfall once the payment has been allocated. We believe that this

amendment will deliver the consumer benefits envisaged in CP16/16 and policy work that preceded it, while not unnecessarily limiting how firms meet our policy objective.

On balance, we believe there is still merit in introducing guidance to support this rule. The guidance makes clear that where sums (including potentially a payment shortfall) have been capitalised in accordance with our rules, those sums would form part of the CMI and do not need to be treated as separate from it. Our rules would therefore not prevent a firm allocating a customer's payments to the CMI, where this includes previously capitalised sums. However, as a consequence of our revision to MCOB 12.4.1BR and in light of feedback, we have made some minor adjustments to the supporting guidance.

Our revised rule and the supporting guidance is set out in the final instrument at Appendix 1.

This consultation did not contemplate changes to our policy, but rather clarification of the existing requirements. We currently do not prevent firms from charging interest on payment shortfalls related fees and charges and this consultation was not intended to alter this approach.

Where a customer has several sub-accounts, and there is a payment shortfall on at least one of those sub-accounts, our new rule drafting makes clear that a firm should allocate payments in an order of priority that will minimise the amount of the payment shortfall after allocation.

Q2: Do you agree with our proposal to clarify the Glossary definition of 'payment shortfall' and provide related Guidance?

- 2.7** Most respondents supported our clarification of the payment shortfall definition. Some respondents, however, questioned specific aspects of our proposal.
- 2.8** Some respondents suggested that the definition should not refer to periodic instalments of 'capital or interest (or both)' as this was potentially ambiguous and created uncertainty about the treatment of previously capitalised sums. These respondents suggested that, if this wording was removed, the guidance at MCOB 2.1A.1G could also be deleted.
- 2.9** Two respondents believed the phrase 'not immediately due and payable under the mortgage contract' was ambiguous. One trade body asked for greater consistency between the Glossary definition of a payment shortfall and the guidance at MCOB 2.1A.1G by having both use the same examples of what is excluded from the payment shortfall definition.
- 2.10** One respondent argued that any reference to capitalisation (when it occurs and its effect) in our proposed guidance would make interpreting the definition difficult.
- 2.11** More generally, a consumer body questioned whether there was sufficient clarity in the payment shortfall definition to ensure that interest on a payment shortfall balance is excluded. In addition, one firm asked whether the Glossary definition of arrears would need updating to align it with our proposed payment shortfall definition, or whether any misalignment was intentional in order to allow items such as unpaid service charges and ground rent to be included in arrears balances.

Our response:

We will revise the payment shortfall definition as planned, but will make some minor adjustments to the accompanying guidance in light of feedback. For example, we are deleting the phrase 'not immediately due and payable under the mortgage contract' as we are content that its removal will not reduce consumer protection or change the meaning of the payment shortfall definition.

On the payment shortfall definition itself, we feel that without reference to 'capital or interest (or both)', the definition would not be clear that the periodic instalment in question is the customer's CMI. The supporting guidance at MCOB 2.1A.1G makes clear that a payment shortfall or other amount that has been rescheduled over the remaining term of the loan in line with our rules does not, in itself, constitute a payment shortfall. But, as such sums would then form part of the CMI (as per MCOB 12.4.1CG), any subsequent missed payments of that CMI would contribute towards a payment shortfall.

The revised payment shortfall definition is intended to clarify what a payment shortfall is. The supporting guidance at MCOB 2.1A.1G aims to complement this by explaining what is excluded from the definition. The different purposes of these two provisions justify the difference in drafting of the definition and the accompanying guidance.

On the reference to capitalisation in the accompanying guidance, while we think that the meaning of capitalisation is clear, we have amended the wording to be more explicit.

On the point raised about the impact of our change to the definition of payment shortfall on the definition of arrears, we consider the existing arrears definition will continue to be effective and therefore confirm that we have no intention to amend it.

Q3: Do you have any comments on the cost benefit analysis (CBA)?

Q4: If firms believe they will incur costs as a consequence of what we believe is a clarificatory change, where will these costs be incurred?

- 2.12** Several firms and their representatives were concerned that our proposed clarification of MCOB 12.4.1BR went beyond our original policy intent and would consequently result in systems costs for firms whose current practices achieve our policy intent, with no additional benefit to consumers.
- 2.13** Other firms confirmed they will not incur any costs or did not respond to these questions.
- 2.14** One respondent stated that firms may incur costs relating to re-training collections and recovery staff, and in reviewing existing systems and platforms to ensure no collections activity would be at risk of falling outside our proposed changes.
- 2.15** One respondent stated that it would not be possible to estimate implementation costs until the final requirements are known.

- 2.16** A consumer body felt that any cost incurred by firms would be due to their non-compliance with the existing requirements.

Our response:

In CP16/16 we explained that MCOB 12.4.1BR always required firms to ensure that any payment shortfall balance was cleared before shortfall-related (non-capitalised) interest and charges were paid. As a consequence, we did not believe our proposal would increase costs for firms who comply with the rule as originally drafted. We remain of this view. We believe that our further refinement of MCOB 12.4.1BR will make the rule easier to understand and that firms already compliant with our rules will not incur costs.

Annex 1

List of non-confidential respondents

1. British Bankers' Association
2. CCAS Limited
3. Christians Against Poverty
4. Coventry Building Society
5. Housing Rights Northern Ireland
6. Money Advice Trust
7. Small Business Practitioner Panel
8. Tipton & Coseley Building Society
9. Virgin Money
10. Yorkshire Building Society

Appendix 1

Made rules (legal instrument)

MORTGAGE AND HOME PURCHASE PLAN PAYMENT SHORTFALLS (CONDUCT OF BUSINESS) INSTRUMENT 2016

Powers exercised

- A. The Financial Conduct Authority 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 (The FCA's general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 15 December 2016.

Amendments to the Handbook

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

Citation

- F. This instrument may be cited as the Mortgage and Home Purchase Plan Payment Shortfalls (Conduct of Business) Instrument 2016.

By order of the Board
8 December 2016

Annex A**Amendments to the Glossary of definitions**

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

Amend the following definition as shown.

- payment shortfall* ~~the outstanding amount to be paid measured against the amount of payments which have become due during the term of a regulated mortgage contract or home purchase plan, including any arrears amount due.~~
- (1) the total sum of periodic instalments of capital or interest (or both) that have become due under the terms of a regulated mortgage contract but which, in breach of those terms, remains unpaid; or
- (2) the total sum of periodic payments towards the purchase price or of rent (or both) that have become due under the terms of a home purchase plan but which, in breach of those terms, remains unpaid.

Annex B

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, unless otherwise stated.

Insert the following new section in MCOB 2 (Conduct of business standards: general) after MCOB 2.1 (Application). All the text is new and is not underlined.

2.1A **Regulated mortgage contracts: guidance on the meaning of “payment shortfall”**

- 2.1A.1 G *A payment shortfall* is defined in the *Handbook* as the total sum of periodic payments of capital or interest (or both) that have become due under the terms of a *regulated mortgage contract* but which, in breach of those terms, remains unpaid. For the purpose of that definition, capital includes any amounts rescheduled over the term of the loan. An amount that has been rescheduled for payment over the remaining term of the mortgage in accordance with the terms of the contract does not form part of a *payment shortfall*. If, following such rescheduling, the *customer* misses a recalculated periodic payment, the full amount of that missed payment becomes part of the *customer’s payment shortfall*. Such rescheduling may only be done in a way that is consistent with the *FCA’s rules*, including those in *MCOB 13*.

Amend the following as shown.

12 **Charges**

...

12.4 **Payment shortfall charges: regulated mortgage contracts**

...

- 12.4.1B R When a ~~customer has a payment shortfall in respect of a regulated mortgage contract, a firm must ensure that any payments received from the customer are allocated first towards paying off the balance of the payment shortfall (excluding any interest or charges on that balance).~~ ;

- (1) a customer has a payment shortfall in respect of a regulated mortgage contract;

- (2) a payment is made which is not sufficient to cover all of the amounts that are currently due under that contract and the *firm* must therefore decide how to allocate the payment; and
- (3) as part of that decision, the *firm* is considering the respective priority to be given to:
- (a) the current month's periodic instalment of capital or interest (or both);
 - (b) the *payment shortfall*; and
 - (c) interest or charges resulting from the *payment shortfall*,

the *firm* must set that order of priority in a way that will minimise the amount of the *payment shortfall* once the payment has been allocated.

12.4.1C G MCOB 12.4.1BR does not preclude a *firm* applying part or all of a payment received to fees and charges not resulting from the *payment shortfall* (such as ground rent settled on behalf of the *customer*).

12.4.1D G A *firm* may recalculate the periodic instalment of capital or interest (or both), provided that any such recalculation is consistent with the *firm's* obligations under the *Handbook*.

If a *firm* exercises a power under the terms of a mortgage contract to recalculate periodic instalments of capital or interest (or both) using a mortgage balance that includes charges (such as *arrears* management charges) or interest arising because one or more monthly instalments were missed, the *firm* does not have to keep a record of the amount of each periodic instalment of capital or interest (or both) omitting any element of such charges or interest to comply with MCOB 12.4.1BR.

Financial Conduct Authority



PUB REF: 005294

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