New edition: November 2009

MLAR RETURN:

A series of Questions and Answers

NEWS:

Securitisations:
Additional guidance is now provided on the reporting of non-traditional forms of securitisation, such as when used as part of the Bank of England's special liquidity scheme. See new QA11b in the General section.

Arrears & Possessions
Additional guidance is now provided on: arrangements; residual debt after possession sales; arrears on bullet loans; reconciling possession flows with stocks; possessions taken & sold in same quarter; and 2nd charge possessions. See new QAs in section F.

Other changes to General section: some questions in the General section are no longer relevant, and so have been deleted (but question numbers have been preserved so that earlier advice to specific firms on particular QAs remains consistent). A few references to SUP 16.7 have been updated to SUP 16.12, and Q6a on entering percentages has been added.

For details of all new QAs please see foot of table below

Date	Version No.	Status	Revision History (notes)
June 2005	1.0	Final	First edition
February 2006	2.0	Revised	New QAs added
April 2006	3.0	Revised	New QAs added
December 2006	4.0	Revised	New QAs added
November 2009	5.0	Revised	New QAs added as follows: • General : Q6a, 11b • Section F: Q6b, 6c, 10a, 13a, 14-16

MLAR: A series of Questions and Answers

General

Q1 Which firms need to complete the MLAR?

The requirement to submit MLAR is set out in section SUP 16.12 of the Handbook, where specific rules deal with the various reporting requirements for each type of firm. For example there are separate rules for banks, for building societies and for firms only undertaking one or more of the new regulated activities of mortgage lending and mortgage administration.

The obligation to submit an MLAR is only triggered however if a firm is authorised to undertake mortgage lending or mortgage administration.

Q2 Deleted: No longer applicable

Q2a Deleted: No longer applicable

Q2b Deleted: No longer applicable

Q3 Deleted: No longer applicable

Q3a Deleted: No longer applicable

Q4 Which sections of the MLAR need to be completed?

The reporting requirements by firm type, in SUP 16.12, provide details of any sections that do not apply. The requirements are also summarised in a table in MLAR Guidance: Introduction, section 2.

Firms completing MLAR (using the online reporting facility) will be presented with all relevant sections of the return. That also means for example, if the firm is a solo-consolidated subsidiary of an authorised credit institution, section C on Capital will not be presented. However:

- Firms authorised for mortgage lending, but not also for mortgage administration, will not need to complete sections G and H

- Firms authorised for mortgage administration, but not also mortgage lending, will not normally need to complete sections D, E or F (in

which case they should be left blank). The exception would be if the firm had non regulated loans on its balance sheet; or if the firm, having previously undertaken regulated mortgage lending but had since surrendered that authorisation, still had regulated loans on its balance sheet

Q5 Do any sections of MLAR only apply in certain financial quarters?

The MLAR is a quarterly return, and firms will need to submit one every financial quarter.

However section J, which collects information on fee tariff measures, only needs to be completed once a year. It should be completed only in respect of each firm's financial quarter that coincides with its financial year end (i.e. its accounting reference date). For all other financial quarters it should be left blank.

Q6 What is the basis of information to be reported in a firm's first MLAR?

The answer depends on the type of information being reported:

a) Where the information on the form refers to for example "advances in the quarter" (or any other volume of business in the quarter), it always relates to only a three month period. The 3 month period is the 3 months to the firm's relevant financial quarter end.

b) Where the information relates to "balances outstanding at end of quarter" etc, it means the balances outstanding in the firm's books as at the firm's financial quarter end:

- So in the case of regulated mortgage contracts being reported, it means the end quarter balance on all such loans advanced since 31 Oct 2004, and still in being at the reporting period end
- While for other types of loan balances, it means the end quarter balance on all such loans that are still in existence, irrespective of when they were originally advanced

Q6a How should we enter percentage figures in MLAR?

Percentages occur in sections D3 (columns 8-10), F1-4 (column 7), and also in H1-3 (column 7).

In general, the online reporting system requires percentages to be entered to 2 decimal places, for example 5.45 or 3.00, which means that a valid zero entry will need to be entered as 0.00 otherwise an error message will occur.

There are however specific validation rules which affect how some nil entries should be made:

- In D3: if the balance reported in column 1, 2 or 3 is zero, then the entry in the corresponding interest rate column (columns 8, 9 or 10) must be left blank. If 0 is entered it will fail because of field format rules (field format should be 0.00), while 0.00 will fail the underlying rule which is that a zero balance in column 1, 2 or 3 must be matched by an interest rate that is left blank in the relevant column of 8, 9, or 10.
- In F1-4 and H1-3, an existing QA in section F at Q4 deals with the special treatment for the 'In possession' lines.

Q7 What types of lending are reportable in the MLAR?

The main analysis adopted throughout MLAR is based on the following types:

- Residential loans to individuals [see MLAR Guidance: Introduction, section 4(ii)] which should be classified according to whether they are regulated or non-regulated (eg as at A3.2 &A3.3, and as at D1.1 & D1.2 etc)
- Other secured loans [see MLAR Guidance: Introduction, section 4(iii)] and shown for example at A3.4, D1.3 etc

In addition, a further analysis is used in sections A and B

- Other loans [see MLAR Guidance for A3.5] but this appears only at A3.5 and at B2.5

Specific guidance is also included on how to treat business type loans that are secured on residential property [see MLAR Guidance: Introduction, section 4(ii) and (iii)]

See also answer to Q13 on what is the definition of a mortgage.

Q7a How do we report a regulated mortgage contract where the LTV exceeds 100%?

Report the whole loan as a regulated mortgage. Provided such a loan meets all of the tests to be considered as a regulated mortgage contract (RMC) it will not fall outside of the RMC definition if the LTV exceeds 100%. Details of RMCs are set out in the MLAR Guidance: see Introduction chapter, in section 4 (iv).

Q8 Does the MLAR include lending done outside of the UK?

The MLAR monitors all of a firm's lending, whether in the UK or overseas. However, only lending secured on UK property is reportable in any detail, while lending secured on overseas property is subject to minimal reporting.

If a firm has branches overseas that are formally part of the firm (whilst not being subsidiaries of the firm) then their lending business should be included in the MLAR along with the rest of the firm's lending business. The approach is:

- If the lending is secured on property in the UK, then it should be classified under the relevant category of UK lending {see MLAR Guidance: Introduction, section 4}, for example following the type of breakdown at A3.1 to A3.4 and similar breakdowns in other sections of the MLAR.
- But if the lending is secured on property outside of the UK, then it should be classified as "other loans". This category however is only used in sections A3 and B2 of the MLAR (as at A3.5 and B2.5).

Q9 If we do overseas lending, where do we report it in section D, E and F?

In this case the firm will be doing mortgage business that enables a borrower to buy an overseas property. The treatment in sections D, E, and F will depend on where the security for the loan exists. Thus,

- if the loan is secured on UK property, then assuming the loan is to an individual, it would be classified as "residential lending to individuals" (either regulated or non-regulated as the case may be). Balances and movements, and arrears would then be reported in sections D, E and F against the same line item classification. (If the loan was to a corporate then it would fall to be reported against "other secured lending", and so on against this item in D, E, and F)
- if the loan is however secured on property outside of the UK, then such loans fall outside of the analysis used in sections D onwards of the return. They fall to be reported only in sections A and B against the category "other loans" at line items A 3.5 and B 2.5 . Hence movements and arrears on such loans are not captured in the rest of the MLAR, and accordingly are not required to be reported in sections D, E, and F.
- our reason for putting the two alternatives, is that a borrower could finance the purchase of an overseas property in either way.

Q10 Does a bank and its lending subsidiary each need to complete an MLAR?

We assume that each of the subsidiary and the bank undertake regulated mortgage lending and/or administration.

If so, then yes, each will need to complete an MLAR return. This is because the approach to reporting is on the basis of the authorised legal entity.

A UK, a non-EEA bank or an EEA bank, as per SUP 16.12, will not however be required to complete sections A1, A2, B1 and C.

But the subsidiary, assuming it is not a bank, and further assuming that it is a mortgage lender, will potentially need to complete all sections of MLAR except perhaps section C (if it is a solo-consolidated subsidiary). This is based on the reporting requirements set out in SUP 16.12and also on the MLAR Guidance: see Introduction, section 2, and in particular the table setting out reporting by firm type. We assume the subsidiary is as per the first row of the table, that is a mortgage lender/administrator with no other activities, in which case footnote a) of that table applies, and because of solo-consolidation does not require section C to be completed. See also the answer to Q4.

Q11 Where are Securitised and Unsecuritised loans reportable in the MLAR?

We use the following notional example for illustration:

a) assume unsecuritised loans of say £100m
b) assume securitised loans as follows:

- gross balances of £500m
- linked funding of £490m (also referred to as non recourse finance in MLAR)
- giving net balances of £10m , which is the amount which contributes to balance sheet footings (ie total assets).
- securitised assets (subject to linked presentation under FRS5) are treated as "off balance sheet" for MLAR, since in effect they do not contribute to balance sheet total assets.

On this basis the reporting treatment across MLAR is as follows:

(i) Unsecuritised loans: these are reportable in MLAR sections: A,B,C,D,E,F

(ii) Securitised loans subject to linked presentation should be reported:

Table A :

- In A3 columns 4 to 7
- As a contribution to A1.6, but only the net balances (ie as shown in A3 column7)

Table D:

- any securitisation transactions in qtr are reportable in D1 column 5, and also in D2 column 3;
- while outstanding balances are reportable in D2 column6 [in our example it would be £500m]

Table G

- In G1.1c and G1.2c. [Balances would be £500m]
- Also in G2.3, in a special entry (see MLAR Guidance on G2.3) for your firm's "own SPVs"

Table H

- Any SPV loans in arrears are reportable here (see paragraph (iii) of section H of MLAR Guidance)

See also Q14a below.

Q11a How should we report mortgages held as part of a pool of securitised mortgages in a Master Trust?

The firm asking the question further noted that:

- *Only some of the loans in the pool were securitised (and held in an SPV)*
- *The other loans held in the pool were described as earmarked for, but not yet subject to securitisation*
- *At any one time, the terms of the Master Trust provided for a designated share to be deemed as securitised (that is, individual loans subject to securitisation were not separately identifiable)*

The answer provided was as follows:

- Those loans (that is the share of the pool) subject to securitisation should be reported in A3 column 4 (and the linked funding shown in column 6). The gross balances in column 4 would also be reportable in D2 column 6, and in section G (G1.1c, G1.2c and G2.3)
- The other loans in the pool, that is those earmarked for but not yet subject to securitisation, should be treated as **un**securitised loans and reported in A3 column 1 until such time as they are formally subject to securitisation.
- These other loans (i.e. to be reported in A3 Column 1) should also be reported elsewhere in MLAR (e.g. sections D, E and F). As the amount of such loans is determined as a designated share of the pool, this will mean that information on loan characteristics (e.g. interest rates etc) will probably need to be ascertained at overall pool level with the actual amount reported in D, E and F etc being determined as a proportion of the overall pool.

See also Q14a below.

Q11b How should we report 'Liquidity securitisations with the Bank of England' or other non-standard securitisations in MLAR?

In order to answer this, we begin by explaining our approach to securitisations and how this influences reporting in MLAR.

Historically, securitisations have typically involved the creation of securities (Notes or loan notes) on a pool of mortgages, and the Notes have then been sold to 3rd parties.

In MLAR, our approach to reporting mortgages has been to separately identify those loans that have been securitised from those which have not been securitised. The reason for this is that under the hitherto conventional approach to securitisation, the risks attaching to such securitised loans were no longer held by the originating lender and instead were transferred to the 3rd party Note-holders. It is a fundamental part of mortgage monitoring within MLAR that we can identify those loans where the risks are retained by the lender, and those loans where (as a result of conventional securitisation) the risks are transferred to 3rd parties.

Up to now the only variant on which we have issued a QA is where loans are held in a master trust for securitisation. That QA is in the MLAR FAQ document, General section, question 11a. There, those loans which are not actually securitised within a master trust, are deemed to be un-securitised and reported as such in MLAR. This is because the lender is still on risk for the performance of those loans. See the QA for specific details.

Since late 2007 however, a further type of "securitisation" has come about. This is where, in order for a firm to avail itself of the **Bank of England special liquidity facility**, the firm has "securitised" a pool of loans and subsequently used that security or Notes as collateral for liquidity. However, it is our understanding that in such circumstances the risks attaching to the performance of the underlying pool of loans remain with the lender and that no risk transfer has taken place to the Bank of England. It is our view therefore that, for MLAR reporting, such loans should continue to be reported within MLAR as un-securitised loans. As such they should be included within A1.6 [if a firm reports section A1/A2] but in any case should be reported within A3 columns 1 to 3 (and not in columns 4 to 7), and then in sections D, E and F in the normal way.

In **other non standard types of securitisation**, that is where either none or not all of the Notes are issued to 3rd parties, our advice is as follows:

- Where a firm itself holds some of the loan notes, then only that portion which is represented by loan notes held by third parties (and where the risk has also been transferred to the third party), should be reported as securitised in MLAR.
- Where a firm itself holds all of the loan notes, then the underlying loans should be reported as un-securitised in MLAR.

Q12 Can you offer guidance on the handling of rounding in general?

The firm provided further background:

- Normally we would adopt the approach of doing the calculation in as much detail as the underlying data allows, and then round.
- However in the example below using D3.1 columns 1 to 3, this would result in the entries not adding up correctly:

a) In Pounds, using un-rounded figures:

Total	Of which at Fixed	Of which at Variable
1987922385.00	730392744.00	1257529641.00

b) When rounded and presented in £ 000 this becomes:

Total	Of which at Fixed	Of which at Variable
1987922	730393	1257530

c) Which is out by 1 (thousand pounds) in this example because both the fixed and the variable totals were rounded up.

The approach should be to report totals, and the items which make them up, in such a way that while each figure is rounded to the nearest £thousand there is also arithmetic agreement. That is, we expect totals reported to agree exactly with the sum of the underlying components. To achieve this it will be necessary, as in the above example, to be selective when rounding: clearly not all elements need to be rounded, otherwise the total will not agree with the sum of the rounded components.

To help firms, we have recently made available sets of validation rules for each of the IRR returns (including for example where items should agree with one another; where components should agree with totals; and any other relationships that exist). They are part of the IRR web pages, under Consolidated returns.

Q13 Can you clarify the definition of a mortgage?

The firm asking the question, specifically wanted to know whether any of the following were included:

- *Contingent liabilities, such as Bonds, Guarantees and indemnities (I understand that in some instances, where UK land is held as security, a Lloyds Guarantee may be a RMC), and*
- *Other facilities where we are 'advancing' against risks such as Forward Foreign Exchange contracts, agreed limits for electronic transmission (so called 'BACS limits'), and other sorts of advances that are outside of the traditional lending products.*

- *Finally, could you please clarify the situation where we may be holding UK land as security for a 3rd party liability, such as a guarantee e.g. a director could guarantee a company's borrowing facilities, which, in turn, is covered by a first party charge over the director's residential property.*

The FSA's view is that any form of financial accommodation made to an individual customer that could result in a debt secured on his/her residential property will fall within the FSMA/RAO definition of a "regulated mortgage contract" ["RMC"], whether or not that debt has crystallised. See our advice on the Q&A section of our website under the Question: "What forms of financial accommodation will be subject to mortgage regulation?":

http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/faqs/mcob.shtml#scope

However, for the purposes of MLAR reporting, we wish to collect information on the subset of RMCs and other mortgages that are "actual" or "committed" rather than those that are "contingent" on an event external to the lender or borrower - i.e. we do not require reporting where there is potential for a financial accommodation to result, at some time in the future, in a loan actually being made or being deemed to have been made.

Specifically, therefore, we do not require firms to report in the MLAR amounts that would be classified as "contingent liabilities" such as bonds, guarantees, indemnities and settlement limits. Nor do we require reporting of guarantees held that are themselves secured on residential property. Please note that this approach does not affect the underlying legal status of the arrangements, and thus the potential application of MCOB rules.

If a contingent liability were to become crystallised at some future date, any resultant loan should be treated for MLAR reporting purposes in the same way as a loan of a similar type that originated in the normal course of business (i.e. did not start out as a contingent liability).

Q14 What is the impact of International Accounting Standards (IAS) on reporting across the various sections of MLAR?

The MLAR Guidance deals with Accounting Conventions at section 5 of the Introduction chapter.

The original text was amended in April 2005 via Instrument 2005/21, which was attached to PS05/5 "Implications of a changing accounting framework – Feedback on CP04/17 & made text" [see Appendix 1, Annex G, Part 3, where there are changes to various parts of the MLAR Guidance contained in SUP 16 Annex 19BG]. For convenience, the updated text of section 5 of the Introduction is shown below, with new text underlined:

"**5. Accounting conventions**

> Unless the contrary is stated in these guidance notes, the return should be compiled using generally accepted accounting practice.
>
> <u>However, information in respect of lending (eg balances, advances, interest rates, arrears etc) to be reported in sections D, E, F, G, H and J of the return should not be fair-valued but should report the contractual position (ie as between lender and borrower)."</u>

Thus the first paragraph of this note refers to generally accepted accounting practice, and that means that if a firm is subject to IAS then it should use that basis when reporting in the MLAR. However, the effect of the amending second paragraph is to confine the IAS basis to sections A, B and C, and to leave the remaining sections on a contractual basis (thereby simplifying the reporting of the various analyses of lending).

There were also a number of other changes related to PS05/5 that were made to sections A, B, C and D of the MLAR Guidance via 2005/21.

Q14a If a firm is subject to International Accounting Standards (IAS), how does this affect the MLAR reporting of securitised loans?

The reporting of securitised loans for MLAR purposes is not on the same basis that a firm would use for its published IAS accounts. Please refer to Q1 in Section A of this document for full details.

For general reporting details of securitised loans, see Q11 of the General section above.

Q15 How do we classify residential loans to individuals (eg buy to lets) that exist as part of a "business loans" type package?

This refers to a situation where an individual has several loans from a lender involving several securities.

This topic is covered in some depth in MLAR Guidance: Introduction, section 4 (ii) and (iii), where the concept of "business loan" type packages is defined.

Essentially the treatment hinges on how the loans are linked to the securities:

- Loans where there is a one-to-one correspondence between the loan and a specific security: report these under "residential loans to individuals"

- Loans where there is no one-to-one correspondence between a loan and a specific security: report these under "other secured loans". These multi-loan/multi-security "business loan" type packages are such that the lender normally assesses loan cover against the basket of securities in the

package. As a result it is not possible to assess such things as LTV or income multiple. Moreover, such lending is different from the range of loans normally associated with "residential lending to individuals". So "other secured loans" is the most appropriate category.

Q16 Could you provide confirmation on signage rules when entering data into MLAR?

The firm asking this question used the following example: *In section D1, Column 6 is a calculated field made up of Col[1]+Col[2]-Col[3]-Col[4]+Col[5]. With existing returns we would normally report most figures as positive figures (regardless of their actual signage). Their signage is taken into account when calculating totals. For example:-*

Opening Mortgage Balances	*50,000*
Advances	*15,000*
Repayments	*5,000*
Write offs	*1,000*
Other Dr/(Cr)	*(10,000)*

Closing mortgage balances would be calculated as 50,000+15,000-5,000-1,000-10,000 = 49,000 . Should we assume the above principles when populating the MLAR return (ie report most figures as positive amounts), otherwise the formulae to calculate column 6 would not work?

These assumptions are correct. As a general rule, all quantities are entered without sign, except:

- where the amount is the opposite of what is normal, (eg a write back would need a negative sign, since that would be the opposite of a write off)
- where a field can be + or - (eg the Other debit/(credit) etc items) , in which case it is essential to use the relevant sign if negative

Q17 Given the reference in C1.4 to "General provisions", what is the meaning of "Provisions" used elsewhere in MLAR such as sections A and B?

In the absence of any qualifying text such as "general" or "specific", the use of the term "Provisions" by itself means all provisions, that is it means the total of general plus specific provisions.

As to its use within sections A and B, its context should indicate whether it is a stock (ie balance of provisions at a point in time) or a flow (ie an amount of provision being charged or written off in respect of a financial quarter or a period of several quarters). For example:

- in A3 it is provisions stock or balance
- in B1.16 it is a year to date flow figure, representing the charge to the P&L
- in B2 the analysis consists of opening and closing stocks and also reconciling flows as follows
- B2 column 3 "provisions charge in financial year to date" will not necessarily be exactly the same as B1.16 since B1.16 covers all provisions charges by the firm (and there may be some that do not relate to loans in B2). But for some firms the figures may be the same
- B2 column 2 and 3 items are :
    - amounts written off so far in the year to date; and
    - charges made during the same period (but they are not purely charges that have necessarily "occurred" as such, since they include charges for anticipated events or as a contingency against losses that may arise, together with some losses that have already occurred)

But C1.4 is only general provisions, and this term is defined in the guidance notes at section C1-2 subparagraph (6).

Section A: Balance Sheet

Q1 If our firm is subject to International Accounting Standards (IAS), how do we report securitised loans in sections A1 and A3?

The answer provided on securitised loans and IAS was:

The method of reporting securitised/SPV loans to FSA in MLAR, for a firm subject to IAS, is the same as before the firm adopted IAS. That is, there is no change.

So please continue to report securitised/SPV loans in A3 columns 4 to 7, in D2 column 6, and in section G and any arrears in section H.

See also explanation below, as well as QAs in the General section of the FAQ at Q11 and Q14.

An explanation of why there is no change in reporting for MLAR purposes is as follows:

- While PS 05/5 made a number of changes to various elements of SUP 16, in particular to the guidance notes on completion of the MLAR (but also other FSA returns) to take account of the impact of IAS on Prudential Capital etc, it was our understanding that we had not altered the underlying basis of how we wished securitised loans to be reported in the balance sheet and related analyses within MLAR.
- Thus the guidance in MLAR (after the impact of PS05/5 and Handbook Instrument 2005/21) is substantially the same for securitised loans as it was before
- The relevant text is in the Introduction section of MLAR guidance, at section 9 (i) paragraph 2, and which is reproduced below (but without colour, so see original) from the version available in the IRR webpages (using link http://www.fsa.gov.uk/Pages/Doing/Regulated/Returns/IRR/index.shtml):

9(i) Positions to be reported gross

In general, liabilities and assets should be shown gross, and not netted off (unless there is a legal right of set-off). Thus an account which moves from credit to debit will move from one side of the balance sheet to the other.

A notable exception to this however concerns the reporting of loan assets, which ~~are subject to 'linked presentation' (e.g. under FRS5)~~ should follow *PRU* 9.3.33R - *PRU* 9.3.35G. Such assets should be shown in the balance sheet net of linked funding and also on this basis in other tables where balances

are reported on the same basis. Only sections A3, D2, G and H require the reporting of such loan assets on a 'gross' basis.

- As a consequence, we are expecting firms to report securitised loans as above. This means reporting them in each of A3 columns 4 to 7, and in D2 column 6, and in G and H
- In section A1, we expect firms to report securitised loans in A1.6, but only on a net basis (ie their contribution to A1.6 will be the A3.6 column 7 amount).
- We are aware that this is not the same as a firm would report in its published IAS accounts ,where securitised loans would normally now appear on the asset side of balance sheet, and the linked funding be reported on the liabilities side. (This would apply to all securitised loans, unless of course they were to qualify for de-recognition under the now more elaborate rules for de-recognition. Accounting Policy colleagues advise that this is likely to be quite rare as a consequence).
- This was a conscious policy decision at the time PS 05/5 was issued, and so we do not expect total assets in the MLAR balance sheet to agree with those in a firm's published balance sheet.

Q2 What other types of lending might be relevant for "A3.5 Other loans" apart from those mentioned in the Guidance?

The firm asking the question asked: *would it include for example lending to subsidiaries or lending to corporate bodies?*

The answers are as follows:

- A3.5 Other Loans is described in the Guidance as:

  > **Other loans** refers to any lending secured on land and buildings outside of the UK, any loan for which security is provided other than by land and buildings, together with all unsecured loans (e.g. consumer credit, personal loans, or such loans to corporates).

- "Other loans" here only has meaning in the context of the lines A3.2- 3.4, that is, what loans are not included in A3.2- 3.4 and hence would fall into A3.5
- However, since A3.2- 3.6 is a breakdown of what would be reportable in A1.6 Loans to Customers (that is, A1.6 is the sum of A3.6 column 3 plus column 7) then it is important to consider what would be reportable against A1.6. Thus, if it would not be reportable against A1.6 then it would not be a candidate for inclusion in A3.5 (or indeed any of A3.2 to A3.4)
- Thus, in addition to those items explicitly included in A3.5 guidance, this category would also include any other loans to "customers"
- Although we do not define "customer", it clearly covers both individuals and corporate entities (since these are mentioned within A3.2 - 3.4 categories)

- We think A3.5 would therefore also include such loans as:
  - inter company loans eg to subsidiaries
  - lending to financial or other institutions
  - potentially "loans" as part of a firm's liquidity portfolio (but in terms of A1 and A2 parts of the balance sheet, such "loans" may be reported within a category other than A1.6, and so may not be relevant to A3.5)
  - but this is provided that none of the above are caught by A3.4 Other secured loans (ie secured on UK land & buildings)

Q3 Could you provide advice on the treatment of Deed Safe Accounts with regard to the MLAR please?

The firm asking the question noted: *We have Deed Safe accounts characterised as follows:*

- there is a minimal balance of £1 owed by the customer
- as lender, we retain the deeds for safekeeping
- the mortgage is not regarded as redeemed
- we still have a charge on the property

As the mortgages are not redeemed we are assuming they should be included in the reporting. If they are to be included do we need to identify purpose, impaired credit history and interest details etc where required in the reporting? Interest is not currently charged on these accounts, which we think will be problematic in section D.

On "deed safe accounts" we advised as follows :

- we mention these in section F at section 2.3 (v), as being items to ignore when compiling arrears figures;
- that could be taken to imply that they are reportable as lending in section D and E etc;
- whilst such accounts might, on a strict legal interpretation by the lender, still constitute mortgages and hence be deemed to be reportable as such in the various MLAR analyses (eg as part of residential lending to individuals), we think an alternative approach is more applicable;
- given that these types of cases are, for all practicable purposes, no longer active loans and in many instances also no longer subject to any applied rate of interest, we think it makes more sense to treat as "other loans " (ie as reported in A3.5 and B2.5 only). This then avoids the main figures for mortgage lending, especially "numbers of loans" in section E of MLAR, being distorted and in effect giving rise to an implied average loan size that is likely to be significantly understated.
- however, since the Guidance Notes do not explicitly cover the reporting of "deed safe accounts", then a firm could adopt either approach. Our preference though would be to see such accounts treated as "Other loans".

Section B: Profit & Loss Account

Q1 What is meant by “non-financial activities” in section B1.1?

The background to this item at B1.1 of MLAR is as follows:

- the P&L needed to cater for a variety of firm types
- most firms would primarily be engaged in lending/banking business
- but some would only be doing lending business as an incidental activity (of which builders were an example when the return was being developed)
- hence we needed a convenient way for the P&L to allow the reporting of two main aspects:
    - income/expenditure on lending and other financial activities (and the breakdown in B1.2 onwards reflects this)
    - income from other sources: this is the role of B1.1, and for convenience we have referred to this category as "Gross profit from non-financial activities"

It is quite likely therefore that many firms who complete MLAR will not have any entry against B1.1, if their business is wholly in the financial sector.

To clarify the use of terms here, and where it may not necessarily be helpful to attempt to be too precise, we offer the following as a guide to the types of activities that we expect firms will include in "financial activities":

- banking, or money-lending, carried on by a bank, building society or other person;
- debt-factoring, finance-leasing or hire-purchase financing;
- insurance;
- dealing in shares, securities, currency, debts or other assets of a financial nature; and
- dealing in commodity or financial futures or options.

With this as background, it should now be easier to identify what is deemed by implication to be "non financial" activities.

Q2 Where should types of provision movement, other than 'Write offs' or 'Provisions charge', for example acquisitions/disposals, transfers, exchange rate movements, recoveries, be reported in B2?

These will need to be "posted" to B2 using either the "write offs" or "provisions charge" columns, since there is no "Other " column.

Amounts that have the effect of reducing provisions balances could be posted via "write-offs”, and similarly amounts that increase provisions balances could go via "provisions charge"

Q3 What is meant by ‘occupancy’ in section B1.11?

We have not provided any definition in MLAR Guidance, so firms have some discretion. But occupancy relates to premises/buildings and so would include such things as rates, rent, insurance of buildings, lighting, heating, depreciation and maintenance etc.

Section C: Capital

Q1 Can you clarify “latest financial year ending” date in section C5?

The firm asking the question noted: *in this section, at C5.2 the guidance says that "Firms should report the amount of total income in their most recent audited (or other) financial statement, and an estimate of income for the current reporting year". We have a financial year end of 31 December, but when we come to complete our MLAR for say 30 June:*

a) how do we interpret “latest financial year ending” date?
b) what is meant by “other” in “audited (or other) financial statement“ above?

The answers are as follows:

a) Latest financial year ending date

- "latest financial year" for C5 means a firm's normal accounting year up to its financial year end (ie its accounting reference date). Here, given the firm is contemplating its MLAR for the financial qtr ending 30/6/05, it would refer to the financial year ending 31 Dec 2004
- the reason for using "latest financial year" is because this is how the measure is defined in PRU 9.3
- "current financial year" would then mean 12 months on from the other one, and so here it is for financial year ending 31 Dec 2005
- the reason for using both "latest" and "current" is that, since "total income" is potentially a more volatile measure than "total assets" in C4, it enables us to assess a firm's anticipated capital requirement for the current financial year as well as the historic position.
- when completing MLAR for the financial quarter end that coincides with the firm’s financial year end, the “latest financial year ending date” is the same as the quarter end date. “ Current financial year ending date” is then 12 months on from that date.

b) Examples of “Other “ for “audited (or other) financial statement”

- one example is where a firm is not necessarily required to have its accounts audited
- another example is when a firm comes to prepare its MLAR for the financial quarter end that coincides with its financial year end: in this case for 31 Dec 2005. At that time, we would anticipate that a firm would report 31/12/05 as the "latest financial year ending" in C5, and 31/12/06 in the adjacent column for "current financial year ending". For some firms their accounts may well have been audited by the time the MLAR is due for completion, but where this is not the case then the term "(or other) financial statements" has relevance and should be taken to mean that a firm will use its own internal/management accounts as a basis for entering this information in C5.

Q2 If we undertake both mortgage lending and mortgage administration activities, should we complete C4 and C5 or just C4?

Only one of C4 or C5 should be completed. So in this case, just use C4.

Q3 Can you advise how Share Premium Accounts should be treated in Section C of the MLAR return?

The firm asking the question noted: *we intend to capitalise a loan from our parent company, issuing some share capital but also creating a share premium reserve. As it is a capitalisation of a loan, the share capital will be fully paid. Should the Share premium sit in 'C1.3 Issued Capital' or in 'C1.1 Reserves'? If it is to sit in reserves (C1.1), does it need to have been audited first?*

The value of the share premium a/c should be included in Audited reserves, see guidance at C1-2 item (3) in the Completion Notes for MLAR, reproduced below:

> "Audited reserves are audited accumulated profits retained by the *firm* (after deduction of tax, dividends and proprietors' or *partners'* drawings) and other reserves created by appropriations of *share* premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a parent company. For *partnerships*, audited reserves include *partners'* current accounts according to the most recent financial statement."

Hence the value of the share premium a/c should be reported within C1.1. However, since it is described as "other reserves" above, and not as "other audited reserves", it is not required to be audited before inclusion.

Section D: Lending – Business flows and rates

Q1 Do "balances outstanding" in D to F only include unsecuritised loans?

In the MLAR, balances outstanding in D, E, and F exclude securitised balances except in the special analysis in D2. Loan balances here are gross balances, that is before the deduction of provisions.

If you look at the columns of section D1, you will see that the "Other debits etc" column in the MLAR Guidance is described as including movements involving any securitisations in the quarter. Hence balances outstanding in columns 1 and 6 are only unsecuritised loans.

D2 is the exception, in that the final column is the amount of loans subject to non-recourse finance, ie loans securitised.

Q1a What is the basis for reporting balances outstanding in D1, and how do they relate to those in A3?

The reporting basis is as follows:

a) balances in D1 are unsecuritised balances

b) balances in D1 are gross balances, that is before the deduction of any provisions

c) balances in D1 are similar to those in A3 column1, but because of Handbook Instrument (2005/21) on Accounting (which made changes to MLAR guidance) they are not exactly the same. As a result of this change, section A3 is on an IAS basis (if the firm is subject to IAS), while D1 (and subsequent tables) is on a contractual basis (ie as between lender and borrower). See Q14 in the General section of these Q/As. The treatment of accrued interest is also another potential source of difference: see Q1b below.

Q1b What is the treatment of "accrued interest" in loan balances in section D?

The guidance notes say relatively little about accrued interest:

- D3 mentions that "balances at end quarter " should include accrued interest
- by implication, since we have indicated so in the Validation rules and because we also imply this in the second paragraph of D3 Guidance, the balances reported in D3 (column 1) need also to agree with those reported in D1 (column 7)
- there is also a reference to "accrued interest" in Section F: Arrears, subsection 1.1 (ii) which says the loan balance outstanding on an

arrears case at the reporting date is the borrower's "total debt at the reporting date...........including interest accrued on the advance (but only up to the reporting date)...."

The points above on D3 imply that D1 column 7 (and hence column 6 also) should also include accrued interest.

The issue now, is what is meant by "accrued interest" in this context. However the only way interest gets added to loan balances in D1 is via "Other debits/credits" column, and the guidance for this column refers only to "interest charged to the loan account during the period" and "interest repaid during the period". There would appear to be alternative interpretations that a firm might adopt in trying to apply this guidance:

- Method 1: would be to assume that by "interest charged to a loan account in the period" is the actual amount debited to the loan account. In which case, any accrued interest in respect of the period between the interest being charged (or debited) to the loan account and up to the reporting period end, is not included. If that is the approach adopted, then the concept of interest accrued in D1 column 6 (and 7) and in D3 column 1 could only mean the excess of the amount of interest charged net of any interest repaid. For most borrowers it would be zero (ie if the loan was performing), and only for loans in arrears would unpaid interest start to mount up.
- Method 2: would be to assume that by "interest charged to a loan account in the period" is the actual amount debited to the loan account, plus any residual interest due to the lender up to the financial quarter end but not so far formally charged to the loan account (ie including accrued interest to the period end).

In a firm's balance sheet, accrued interest will apply to both sides. On the liabilities side it will for example include amounts of interest accrued on a depositor's account up to the balance sheet date that have not yet been paid or credited to the account (it is expected that this would appear within the reported figure for deposit balances), and there would be an equivalent treatment on the assets side. That is, loan balances would be expected to be reported inclusive of accrued interest in the balance sheet.

But how does this balance sheet treatment of accrued interest for loan balances link to reporting of loan balances in section D onwards:

- under Method 1 above: the amount of accrued interest would be included in the balance sheet entries (eg A1.6 and A3), but not in section D onwards (noting the exception for loans in arrears in section F)
- under Method 2 above: the amount of accrued interest would be included in the balance sheet entries (eg A1.6 and A3), and also in section D onwards .

- NB: loan balances in section E3 to E6 are expected to agree with the corresponding balances reported in D1 (column 7) as stated in the validation rules

As to materiality, let us assume that mortgage interest is say 6% per annum. That is 0.5% per month, and so if a firm debited interest to loan accounts at mid month, then accrued interest in respect of the period from mid month to end financial quarter would amount to no more than 0.25%. So the difference in treatments is unlikely to be material.

We do not know how firms are interpreting the guidance on section D for these aspects related to accrued interest: many might go for method 1, whilst others might go for method 2. The difference is unlikely to be material, and therefore we are neutral as to which method is adopted.

Finally, we should note that there is no expectation that entries in A3 (column 1) will necessarily be the same as corresponding entries in D1 (column 6). Accordingly there are no such cross checks in the validation rules (see those published in the IRR web-pages). This is partly because of potential issues such as accrued interest, but also because if a firm is subject to International Accounting Standards (IAS) then we have now stated (in Handbook Instrument 2005/21) that while sections A, B and C of MLAR should be compiled on an IAS basis, nonetheless sections D onwards should be compiled on a contractual basis (ie as between lender and borrower).

Q2 What should be entered in column 6 of section D2 of the MLAR?

This section D2 deals with two types of information:

- The first 5 columns report a breakdown of loan book movements that have already been reported in the Other debits/(credits) etc column of section D1.
- Column 6 of D2, “Balance at end quarter on loan assets subject to non-recourse funding”, is a memorandum item that is not directly related to the first 5 columns. It is explained in detail at the end of the MLAR Guidance for section D2, and is the gross amount of loan assets subject to non-recourse funding as part of a securitisation.

If your firm has any securitised loan assets, then column 6 will be relevant, otherwise not. If your firm does have any securitised assets, then your financial team should be familiar with the terms used in the MLAR Guidance, since they are also relevant in the preparation of a firm's published accounts. Indeed, the analysis presented in A3 (final 4 columns) is related, and we would expect the balances presented in D2 column 6 to “agree” with the underlying gross securitised balances presented in A3 (column 4, that is before the deduction of provisions), unless of course a firm is subject to International Accounting Standards (when sections A, B and C are on an IAS basis, but sections D onwards are on a contractual basis: see answer to Q14 in the General section of these Q/As).

Q3a Should "Advances" reported in D1 and D4 also agree by type?

The firm asking the question noted: *in sections D1 and D4 we have to report Advances made in quarter and we understand that the entries in these should agree. However should the entries in the regulated/non-regulated splits agree? In the following example how should the advances be reported in each section?*

£100k is offered and completed in January as a non-regulated contract. However shortly after completion the £100k account changes from non-regulated to a regulated account also in January. How should this be reported under the advances sections of D1 and D4 (Commitments)? Should both sections show the 100K under regulated part of the advances section? Or should D1 show the £100k as regulated and D4 show the £100k as non-regulated as it was originally a non-regulated advance?

The answers are as follows:

a) Yes, we expect the figures for Advances in D1 and D4 to agree, and also by regulated/non-regulated categories etc as well.

b) So in the example, both D1 and D4 columns referring to Advances should report the transaction as "Regulated"

Q3b How should we handle changes in loan categorisation in D1 and D4?

In the more general situation, where a loan categorisation is subject to change sometime after the original transaction is made, we think this could be handled by posting suitable amending transactions to bring about the necessary result.

The following is one suggested approach:

- Where a Commitment (that has already been recorded in the firm's systems and would then be reported in column 2 of D4 of the current period's MLAR) undergoes a subsequent change in its categorisation (e.g. from non-regulated to regulated, or from house purchase to re-mortgage etc)
    - *during the same quarter* , this can be accommodated via the "cancellations in quarter" column. That is, cancel the original commitment, and report the revised commitment on the row that is now relevant under the column "commitments made since end of previous quarter".
    - *during a later quarter than the original* : follow the same approach if the loan has not yet been advanced. But if the loan has been advanced, then the commitments balance outstanding will no longer include this loan, and hence should not need amending

- In the case of an Advance (that has already been recorded in the firm's systems and would then be reported in column 2 of D1 and column 4 of D4 of the current period's MLAR), we have no equivalent to the "cancellations " column, so we suggest this can be reversed as follows:
  - *for changes occurring in the same reporting quarter* as the original transaction: by posting an entry under "advances in qtr" which is the same amount as the original but this time with a negative sign. Then post the newly categorised loan against the correct line item (eg now regulated in the example in Q3a)
  - *for changes occurring in a later reporting quarter* than when the original was reported: by posting a negative entry under "other debits/credits" in relevant line in D1 and an equal and opposite signed entry in the "correct" line in D1 (which will have the effect of transferring balances to the "right" loan category.

If however a firm's reporting of advances and/or commitments (or indeed any other item) for a previous period was considered to be materially incorrect, the firm should revise its figures in respect of the already submitted MLAR and resubmit a revised version.

Q3c How should we deal with 'cancelled advances' in section D?

The firm asking this question noted:

- *This refers to the situation where either the advance cheque is not actually presented before cancellation, or where the advance payment is made and subsequently returned or cancelled, within usually a short period due for example to delayed or postponed completion.*
- *In the Q&A guidance for Section E, the following text appears in relation to a point raised under the 'number of advances section' of the MLAR re cancelled advances:*

> **Q12 How to report "number" of advances in situations involving stage payments and further advances? A series of five related questions, shown below as a) to e).....**
>
> ....b) If the advance was reported in the previous quarter, but the advance was cancelled during the quarter under review, should the number for the quarter under review reflect this (i.e. deduct 1 from the number count for the quarter under review)? ***Answer = No***. Only report actual advances. "Cancelled advances" (presumably reported under repayments in D1) should not feature in "gross advances" in D1 or in E3, E4, E5 or E6.

- *In this particular scenario the guidance relates to cancelled stage advances.*

- *Can you confirm whether the same treatment, as spelt out in the last part of the QA shown above, should be applied to all cancelled advances?*

The answer provided was as follows:

The original QA in section E at Q12 b), and which arose in the context of how to report "numbers" of loans in E, is addressing the particular occurrence of a cancellation transaction in a later quarter than when the original lending transaction took place. As such, it mentions in the answer -in brackets- the presumption that the £amount of the cancelled advance would be treated as a repayment in D1.

Building on this, and the reference in the MLAR Guidance Notes for D1 under "Gross advances" at point (e), namely that "Advances made in the quarter" should include "the deduction from advances made of advance cheques cancelled", we can advise as follows.

In the case of an Advance made to a borrower (that has already been recorded in the firm's systems and would be reported in column 2 of D1 of the relevant period's MLAR), and where the loan is subsequently cancelled, we suggest the "cancellation" is reported as follows:

- Where the loan has not been drawn down, e.g. the advance cheque has not been presented nor the amount drawn down, then either ignore both the advance and the cancellation as if they had not occurred, or treat the "cancellation" as a negative advance within "advances". The cancellation will therefore offset the amount already includable in that quarter's figures for the underlying loan advance.

- Where the loan has been drawn down, then we suggest the "cancellation" could be reported:
  - if the transaction occurs in the same quarter as the advance is made: then either ignore both the advance and the cancellation as if they had not occurred; or report as either a negative advance within "advances" or as a repayment in D1 column 3.
  - if the transaction occurs in a subsequent quarter to that in which the advance was made: then report as a "repayment" in D1 column 3.

Q4 How do we report a further advance for a borrower to acquire a further share in a shared ownership scheme?

In the case of a shared ownership case, any loan to finance an existing borrower's acquisition of a further share in the scheme should be reported in MLAR as follows:

a) as a commitment: report in section D4 against "House purchase", as a further part of the house is genuinely being purchased.

b) when actually advanced: report in section E6 against "House purchase"

c) in section E1/2, the £ amount reported is the further loan amount, and when calculating the LTV percentage for shared ownership:

- Loan is the sum of old loan + further loan etc (ie as per point (i) (b) of guidance notes for "Loan to valuation ratio LTV" under Section E1/2 of the MLAR Guidance.
- Valuation is calculated on the borrower's shared ownership proportion of the overall property valuation, and not the whole property valuation

Q5 When to treat sundry debits as part of advances and commitments?

a) When is a sundry debit classed as being formally part of the loan?

Where the amount is repaid over the term of the loan, with no expectation of it being repaid either at time of advance or very soon after.

b) Should valuation fees and arrangement fees be included in the Loan Commitment and Advance amounts, regardless of whether they are included in the Offer of Advance amount or not, if they are debited to the mortgage account on completion?

Valuation fees, arrangement fees or any other item of expense should only be included in Commitment and Advance amounts where they are formally treated as part of the loan (as described above). This is regardless of whether included in the Offer of Advance amount.

Q6 How should the originating lender, the society, and the third party administrator each report the following transactions involving equitable sales of mortgages?

The building society asking the question explained the transaction as follows:

The Society has entered into an agreement to acquire, by equitable sale, individual mortgages at the time of completion from another FSA registered company. Additionally, the mortgages are administered by a different FSA registered company.

For each transaction the lender's brokers actually give the advice, the lender takes out the mortgage, but the Society funds the transaction and obtains the rights and benefits to each mortgage through the equitable sale. Subsequently the net effect is that the Society has funded each mortgage and each mortgage is administered for the Society by another FSA registered company.

The answers are as follows:

a) the originating lender makes the advance and the loans go on that firm's balance sheet (however short a time this might be). That firm's MLAR should report such advances in the normal way eg under D1 "advances in qtr".

b) that firm then does an equitable sale/transfer: its MLAR should report such transfers in accordance with MLAR Guidance (ie in section D1 under "other debit/(credits)" as a negative figure, and in section D2 under "loans sold")

c) the society purchases such loans by equitable sale/transfer: the society's MLAR should record these as "loans acquired": which means in section D1 reporting the amounts under "other debits/(credits)" as a positive figure, and in section D2 reporting them under "loans acquired. (But it would be incorrect to treat them as the society's "advances".)

d) as regards loan administration:

(i) when the loans are acquired by the society, then assuming the society has an authorisation for loan administration, the society would be regarded as administering its own loans (even though outsourced to a third party) and should tick the box at G0 in table G of MLAR, and hence not report any specific information on these particular loans in table G

(ii) the third party administrator, if it has authorisation to undertake loan administration, would be required to complete an MLAR. In respect of those loans in your scenario that are administered for the society, the third party administrator should report them in table G(1) "as Other administrator". This is because the society would be assumed to be the principal administrator (even though it out sources the loan administration).

Q7 How do we report loans that we originate but then transfer to an SPV?

The firm asking the question noted: *although we retain the legal title to the mortgages we transact, we sell the equitable interest to a third party. This happens automatically with each completion so that at the end of each reporting quarter we would always return a nil balance i.e. we do not retain any loans on our books.*

There are two possibilities for the “third party” here:

- another firm (not connected with the originating lender, as in Q6)
- a special purpose vehicle (SPV) which is economically connected to the originating lender, and where the SPV loan assets are shown on that lender’s balance sheet using the linked presentation method

The reporting treatment is as follows:

- if the loans are being transferred to an SPV, then there is still reporting relevant to MLAR
- before loan transfer, the actual advances are reportable in the firm's MLAR, eg in D1, D3, D4 and also in table E, even if they are transferred before the reporting qtr end
- loan balances transferred should be reported in D1 (column5) and also in D2 (column 3 if securitised, or column 2 if otherwise)
- if the loans transferred are subject to the linked presentation method of accounting under FRS5, where entries are made on your firm's balance sheet but offset by linked funding (see MLAR Guidance: Introduction [section 9(i)], and Section D [subsection D2]), then such loans are still reportable in parts of MLAR: A3(cols 4-7); D2(col6); and in G1.1c and G1.2c, and G2.3, and also in H

Q8 In D4, does 'Commitments made since end of previous quarter' include borrowing limits which are not taken up by the borrower, but which could be at some point in the future?

The firm asking the question provided an example: *say the customer asks for a £100,000 mortgage and the financial institution agrees to this. In addition they also offer a draw down facility of £20,000 which makes the borrowing limit £120,000. Does this mean the commitment is £120,000? And does the advance of £100,000 leave an outstanding commitment at the end of the quarter of £20,000?*

"Commitments made since end of previous quarter" in table D(2) should include all amounts which the firm has formally agreed to advance, and is therefore committed to lend to the borrower, whether now or in the future. As such it would include any drawing facilities that have been agreed, and in the example you quote:

a) the initial commitment would therefore be £120,000 and

b) after the £100,000 advance has been made, the commitment outstanding at the end of the quarter would then be £20,000 until such time as any drawdown was subsequently made.

Q9 In section D1, could you please provide guidance on converting currencies to sterling in respect of brought forward balances.

The firm asking the question provided further background and an example: *the Guidance Notes state that the currency should be translated into their equivalent sterling value using an appropriate rate of exchange at the reporting date.*

If the base currency is for example euros (and an exchange rate of 0.67) and we have a closing balance at the end of quarter 1 of EUR 1,000,000, this will

translate to £670,000. If at the end of quarter 2 the exchange rate is 0.68 then the opening balance for quarter 2 is still EUR 1,000,000 but this translates to £680,000.

Should the opening balance for quarter 2 be reported as £680,000, otherwise I would imagine that the transactions across the line would not balance as different conversion rates are used?

There are two possible ways of dealing with "balances at start of quarter":

a) A lender reports the sterling opening balance figure to be the same as the closing balance reported for the previous quarter. In situations where none of the loans are denominated in currencies other than sterling, we would generally expect opening balances to agree with previous quarter closing balances (perhaps with any minor difference reflected in other debits/credits; but any significant difference probably needing revised figures submitting for the previous quarter). If that approach were to be followed for situations involving non-sterling currencies, then the difference arising on currency translation could be posted via other debits/credits, otherwise the analysis across the columns would not reconcile.

b) A lender reports the sterling opening balance figure, but on the basis of applying the currency conversion rate applicable at the end of the current reporting period. All columns should then reconcile (assuming of course that the underlying amounts pre-conversion also reconciled). In this situation the opening balance would differ marginally from the closing balance reported at the end of the previous quarter. This is the method shown in your example.

However, we have not commented specifically on this aspect in the MLAR Guidance. That means that some firms could be planning to adopt the first approach, and some the second. Indeed, there would not appear to be any reason for ruling either approach as invalid. In the circumstances, our approach would be to accept either approach as being valid.

Q10 We are analysing the amendments made under FSA 2004/79 regarding the requirements to report Overdrafts in section D1 and what is classified as an overdraft. The guidance notes indicate two types of revolving credit facilities: overdrafts and credit cards, but I am unsure how overdrafts relate to mortgages, particularly with credit cards.

"Overdrafts" fall into two broad categories: those that are secured on land and buildings (ie a mortgage), and those that are unsecured.

Unsecured overdrafts are likely to constitute the majority of overdraft facilities offered by financial institutions. For MLAR purposes they are reportable only as part of A3.5 and in relation to B 2.5

However those overdrafts, which are secured, are includable within all categories of Mortgage lending in D1. The MLAR Guidance mentions secured overdrafts and other forms of secured credit, at the end of section 4 (last paragraph) in the Introduction chapter. While this is in the context of the range of loans caught by the definition of a regulated mortgage contract, the concept applies equally to other categories of lending and an overdraft could exist as a secured overdraft as part of each of the lending categories in D1.1, D1.2 or D1.3 etc.

The purpose of the new "of which" analysis in D1 columns 7-9 is to separately analyse those overdrafts already in D1 column 6, and then exclude them from certain later analyses (eg D3, E3-6 [see second paragraph of section E of MLAR Guidance as amended by 2004/79] and F [see Introduction paragraphs of F as amended by 2004/79] etc).

We have defined "overdrafts" as covering two types of revolving credit facilities: overdrafts {by which is meant the normal banking products of that name that are normally linked to a current account} and credit cards. Therefore this term "overdraft" would not include:

a) those elements of a mortgage constituting extra drawing facilities (eg those reported in E5)

b) those elements of a mortgage constituting the facility to draw down that arise because of overpayments (excluded from E5).

Q11 Do overpayments on qualifying loans create additional commitments?

Because we define "Commitments" in section D4 sub paragraph a) of MLAR Guidance as "formally agreed advances", it is not expected that firms will necessarily treat "overpayments" (where, under the terms of a loan, such an event creates an ability to re-borrow) as new reportable commitments.

However, if the borrower subsequently re-borrows any overpayment such that the lender needs to report an actual "advance", this has implications for D4 in particular (but advances will need to be reported elsewhere too). If there is no compensating "commitment" made, then the stock of commitments will be reduced and that would be inappropriate, as it would understate the true level of commitments. It is suggested that whenever an "advance" of this nature is made for which there is no pre-existing commitment, that an amount equal to the advance is added to "commitments made since end of previous quarter" in D4, so that there is no diminution in the underlying stock of commitments.

Q12 Should drawdowns on flexible mortgages be included in "advances" and "commitments"?

Drawdowns should be included in figures for further advances in E6.3, and hence in figures for overall advances in D1 under "Advances made in quarter". They also need to be taken into account when compiling figures for commitments, but how this is done will depend on the type of drawdown.

There are two types of "drawdown":

(i) drawdowns on loans with an extra drawing facility, that is those types of loans described in E5. These types of loans have a formal commitment from the outset to lend the "extra amount" agreed at the time of making the original advance. Hence we would expect such unutilised commitments to formally be included in figures for Commitments at D4 at the time of the original commitment being made. So there should not be a problem of subsequent drawdowns being reported in "advances in qtr" in D4 (and of course in D1, where there is specific guidance at D1 d), and hence reducing commitments balances without any corresponding commitment being included in the brought forward balances.

(ii) drawdowns on loans where, under the terms of the loan, the event of an overpayment creates a facility for the borrower to subsequently withdraw any overpaid amounts (possibly subject to conditions on minimum/maximum amounts etc). Here, the event of the borrower exercising this facility means that an amount of money is "advanced" by the lender to the borrower, and the loan balance outstanding increases by the same amount. Hence such movements need to be reported in advances in D1, and the MLAR Guidance at E6.3 implies that this should also be reported in advances there as well. To deal with the analysis of Commitments at D4, it is also necessary to take this type of drawdown into account. One method would be for the "commitments made in qtr" figures to include an amount equal to any drawdowns of this type that are actually made in the qtr. Another method would be to create a new commitment every time a qualifying overpayment was made, but this would tend to overstate the likely amount that would ever be drawn down (as not every borrower would exercise the facility) and so a lender might need to only regard a proportion of such notional commitments as reportable commitments for D4 purposes. We think this is a matter for the lender to decide in the context of the product characteristics, but the first method is probably easier to implement and avoids the risk of significantly overstating commitments.

Q13 How do we report 2nd charge lending in section D?

The firm asking the question noted: *should we categorise our* ***2nd*** *charge lending as 'other secured loans' for the purposes of form D? Is this correct given that some of our* ***2nd*** *charge loans are regulated by the Consumer Credit Act (CCA), and others are entirely unregulated?*

The answer provided was as follows:

- We think this is unlikely to be correct

- For MLAR purposes there is no distinction between 2nd charge loans covered by the CCA and those that are not. In MLAR, the term "regulated" means specifically that it is a regulated mortgage contract as defined by the FSA (see MLAR guidance, Introduction, section 4 (iv)): but the fact that it is regulated under the CCA has no relevance in terms of the MLAR use of "regulated".
- "2nd charge lending " needs some clarification before deciding on how to classify:
  - If it involves loans to individuals secured on residential property, then it should be classified as "residential loans to individuals: non-regulated" eg D1.2. The Introduction chapter of the MLAR guidance mentions that this category includes 2nd charge lending at section 4 (ii), paragraph 2; and 2nd charge loans are also given as an example of non-regulated mortgage contracts in paragraph 4 of that same section.
  - Thus it is likely that much of a firm's 2nd charge lending will be reportable under this category of "residential loans to individuals: non-regulated"
  - But if there are any 2nd charge loans that do not satisfy the characteristics of "residential loans to individuals", for example if the loan is to a corporate, or if the loan is to an individual but less than 40% of the land & buildings is used for residential purposes, only then would such a loan be classifiable as "Other secured loans " as for example at D1.3

Q14 In section D4: Commitments, where should Further Advances be included – under House purchase, Re mortgage or Other?

The terms house purchase (HP) and re-mortgage (RM) are also used in E6, and although there is no explicit link in the guidance notes to that effect, we suggest you follow the guidance in E6, which means that:

a) HP [at D 4.1(a) /D 4.2(a)]: should be approached in the same way as items E6.1 and E6.2

b) RM [at D 4.1(b) /D 4.2(b)]: should be approached in the same way as items E6.4 and E6.5

c) "Other" [at D 4.1 (c) /D 4.2(c)]: should then be approached in the same way as all other E6 items, i.e. E6.3, E6.6 and E6.7

Since in E6 it is clear that Further advances (FA) are to be reported in different ways depending on their nature/purpose (see next paragraph), then this treatment should also be followed when reporting a FA both as a commitment made and as an actual advance made in section D4.

In E6, further advances are reported as follows:

- FAs on buy to let are reported against E6.2 Buy to Let. Thus include in HP in D4.
- FAs on lifetime loans are reported against E6.6 Lifetime Mortgage. Thus include in “Other” in D4.
- Other FAs are reported against E6.3 Further Advances. Thus include in “Other” in D4.

Also, it is important that when a particular FA is reported in D4, whether as a commitment or as an advance, that it is classified in the same way each time.

Q15 How should we deal with a loan commitment case in D4 where a potential borrower receives one or more revised loan offers?

The firm asking the question explained: *a customer may get an offer during the reporting period say for £100,000. Three days later they may come back and say they want £105,000 instead, so we cancel the original offer and create a new one. A month later in the same period they may come back and say actually we need £120,000 e.g. for home improvements not originally allowed for. The offer for £105,000 gets cancelled and a new offer of £120,000 gets created. The question is, should we report 1 offer for £120,000 or three offers and two cancellations?*

Ideally the firm should report the most recent "offer" but if this is not viable, because of how offers and cancellations are recorded or processed in the firm's systems, it would be equally acceptable to report 3 offers and 2 cancellations.

In most cases we imagine a borrower will probably only be subject to one offer in a quarter, and so for the minority that have multiple offers it is unlikely to make a significant difference to "new commitments" figures. Moreover, the impact on the figure for net new commitments" (a key measure derived by us from new commitments less cancellations) will be nil.

Section E: Residential lending to individuals - New business profile

Q1 How is LTV calculated for shared ownership loans?

Taking as an example:

- Property value £100,000
- Customer buying 50% share (£50,000)
- Loan Amount £40,000

The reference to "valuation", at the end of section E1/2 of the MLAR Guidance dealing with the concept of "Loan to valuation ratio", includes the following text: "valuation is to be taken as the most recent valuation of the property which is subject to the mortgage...."

In the case of shared ownership, "the property which is subject to the mortgage" means that part of the property subject to the mortgage. This is because the lender only has security on part of the property, and not the whole of the property. In the event of default the lender could only reckon on 50 % of the total property value.

In the example quoted therefore, the relevant valuation is £50k, and the LTV ratio is therefore 80%.

Q2 How should the LTV be calculated where the reporting lender makes a second or subsequent mortgage on a property where there is already a first charge to another lender?

For the purposes of MLAR, the LTV for the reporting lender's second or subsequent mortgage to this borrower should be calculated as follows :

a) Loan (for the purpose of LTV): is the amount of the reporting lender's loan to the borrower plus the amounts of any existing loans to that borrower from other lenders and secured on the same property.

b) Valuation (for LTV): is the amount of the overall property valuation.

Taking an example, where the property is valued at £250k, with the borrower having an existing loan from another lender of £100k. If the reporting lender makes a second loan of £120k then:

(i) Loan for reporting lender's LTV is: £100k + £120k, ie £220k

(ii) Valuation for reporting lender's LTV is: £250k

(iii) Hence LTV is (220k/250k)*100 which is 88%.

This has the merit of both making the LTV calculation consistent with that for the 1st charge loan and also produces a more realistic measure of the actual risk posed by the loan. In reality the 2nd charge lender is exposed to a 12 %+ fall in the property value, rather than a 20% fall that would appear to be the position if we were to adopt another approach to LTV that simply looked at the reporting lender's loan of £120k and divided it by the net valuation (ie valuation less existing loans to other lenders) of £150k to give an LTV of 80%.

Q3 Should guarantor income be used in the calculation of income multiple?

"Income" in E1/2 means only the income of "borrowers".

- Thus a straightforward conventional guarantor should be ignored when calculating the income multiple, since that person is not a "borrower"

- However if for example a lender has a product for young professionals, where the person that might otherwise act as a guarantor (eg a parent) is instead formally joining the mortgage contract as one of the borrowers along with the young professional, then in those circumstances the parent's income should be taken into account along with the incomes of other borrowers when calculating the income multiple. But we would see the parent's role here as joint borrower rather than as "guarantor".

Q4 Should capitalised fees be included in the loan amount for the LTV calculation?

The firm asking the question noted: *section D1 (h) states that sundry debits should not be included in advances e.g. fees, unless they are formally treated as part of a loan. If a customer decides to capitalise fees incurred against the loan, but this money is not actually advanced to the customer, should the capitalised fees be included in "advances for the quarter" and in the derivation of "the Loan to valuation ratio", as my understanding is that capitalised fees would be treated as part of the loan?*

In the example given, "capitalised fees" would appear to be amounts that are formally treated as part of the loan (i.e. there is no intention that they should be paid upfront by the borrower, and rather should be repaid over the period of the loan) and hence in accordance with the MLAR Guidance should be included:

- Within the amount reported under "advances", in for example D1 and in section E,
- In the "loan" amount used in the LTV analysis in section E1/2

NB: see also related answer to Q5 in section D, dealing with sundry debits.

Q5 If the borrower's credit history changes at the time of a further advance, do we apply this to the whole loan or only to the further advance?

Apply it to the total loan amount. That is,

- If the borrower now has an adverse credit history, then against line item E3.1: report the further advance amount under "Gross advances in qtr", and report the total loan amount under "Balances outstanding".
- If the borrower no longer has an adverse credit history, then against line item E3.2: report the further advance amount under "Gross advances in qtr", and report the total loan amount under "Balances outstanding".

The MLAR Guidance now covers this explicitly (see last paragraph of section E3), along with a requirement to formally re-assess credit history at the time of a further advance.

Q6 At what point in the process is a borrower's credit history assessed?

The credit assessment undertaken 'at the time of making the loan' (as described in MLAR Guidance: E3, first paragraph) is meant to recognise that lenders will normally assess credit history at an early stage, and that in practice this check is usually made at around the offer stage. While this is somewhat before the loan is actually advanced, it is nevertheless deemed to be part of the overall process of 'making the loan'. (The MLAR Guidance now makes this "timing" more explicit.)

Q7 We use more stringent criteria for assessing credit history when deciding to make a new loan. Can we use this basis for reporting in section E3?

The purpose of detailed definitions in the MLAR Guidance is to achieve a number of outcomes: to ensure consistency of reporting by all lenders; to ensure that comparisons between firms can be done on a like for like basis; and to enable meaningful industry statistics to be compiled in due course. We would therefore expect your firm, along with others, to report on that basis, as per the guidance notes. That would not prevent the firm from continuing to use its own criteria for its own assessment purposes, but the MLAR should be compiled on the basis of the specific definitions set out in section E3.

Q8 We anticipate some difficulties in compiling impaired credit history (ICH) data for section E3 in respect of loan advances between 31 October 2004 and 31 March 2005. What scope exists for reasonable approximations in respect of this initial period?

The firm asking this question noted: *our usual credit reference agency will not be able to offer an assessment of ICH for its customers that is fully in line with the criteria in E3 until Q2 2005. It has therefore proposed a retrospective analysis service of regulated advances made from 31 October 2004 to 31 March 2005. Whilst we, as a lender, will ourselves have collected ICH data as part of the application and loan assessment process, this is not necessarily as comprehensive as that implied by the ICH criteria in E3.*

The firm does need to assess credit history in respect of all regulated loans made since 31 Oct 2004: how it does this is a matter for the firm. Some firms may have collected ICH information as part of the application form/process, while others may have used credit reference agencies. But it is the firm's responsibility to satisfy the reporting criteria in section E3 of MLAR Guidance, although how it undertakes the necessary assessment is a matter for the firm to decide.

We would also note the section on "Accuracy" in section 6 of the Introduction chapter of the MLAR Guidance, and in particular the reference to "close approximations". Such approximations may be appropriate in limited circumstances and limited duration, for example at the start up of a new reporting requirement. We would hope that this, coupled with the advice in the paragraph above, and the presumption that the firm already has credit history information in respect of regulated loans advances between 31 October and end March, would enable the firm to satisfy the requirements of section E3, noting also that a firm should (if in doubt) err on the prudent side when making an assessment of ICH. For example it would not be unreasonable to classify a case as having an impaired credit history for the purposes of E3 if there was only limited evidence of impairment.

Q8a Should missed payments on credit cards be included under impaired credit history in E3?

Credit history is based on a number of criteria in MLAR. Each of our criteria is included as a basis of assessing a borrower's past performance in dealing with loans (including both secured and unsecured loans). For many people, their only credit exposure before applying for a mortgage may have been an unsecured loan.

But we can however confirm that we do not view "unsecured loans" as including any form of revolving credit, for example overdrafts and credit cards.

Q8b In section E3 on Impaired Credit History, does the criterion of being subject to an IVA or bankruptcy order "within the last three years" refer only to the start date?

No. The reporting requirements "within the last 3 years" are based upon the end date of the conditions that the individual is subject to.

The event of "being subject to an individual voluntary arrangement (IVA) or a bankruptcy order at any time within the last three years" means that the terms/conditions of the individual voluntary arrangement (IVA) or bankruptcy order were in force for at least part of that period.

Thus the test is not simply of when the individual voluntary arrangement (IVA) or bankruptcy order started, but whether the end date of the conditions that the individual is subject to has either occurred within the last three years or is set to occur at some time in the future.

Q9 Do loans with extra drawing facilities, reported in E5, also include self-build mortgages as the loan is drawn down in stages during construction?

Self-build mortgages are really loans involving stage payments for house purchase and as such should be reported in E6.1/2.

We would not regard such loans as having a drawing facility, and they are effectively ones where staged payments are expected.

As such we can confirm that such loans should not be included in the category of loans covered by E5 (loans with extra drawing facility): where the drawing facility is meant to be one exercisable by the borrower, eg via cheque book, on line transaction, or on demand. (The MLAR Guidance now covers this explicitly.)

Q10 Do we assess "first time borrower" status on the basis of the first named party, the second party or both?

Section E6.1/2 of the MLAR Guidance, second paragraph, refers to first time buyers as "FTBs, that is where the tenure of the main borrower immediately before this advance was not owner-occupier". For this purpose, we suggest "main borrower" means the borrower having the highest income, and hence it could be either the first or second named.

Q11 How should we classify an existing owner occupied residential mortgage where the property is to be let out for a period of time and could come back to a residential loan in due course?

Here the firm is wondering whether to reclassify as a buy to let loan. Our advice in such circumstances is that we think it is not necessary to reclassify the loan from its original purpose, if there has only been a change in use.

This is based on the premise that a regulated mortgage contract (RMC) is defined in terms of the conditions pertaining at the time it was entered into. This implies:

(i) that it remains an RMC even if, subsequently, some of the original conditions are no longer satisfied

(ii) and moreover, that only if the loan contract is formally revised or replaced, is it necessary to reconsider the status of the loan.

This approach to loan classification would seem appropriate for other types of loans and not only those which are RMCs.

As a general rule, a loan would only need to be reclassified if there is a further transaction on the mortgage and if that transaction resulted in a different purpose or a different legal status. For example: if the mortgage was formally changed from a residential loan to a buy to let loan, or was converted to a lifetime mortgage, or became a non-regulated contract.

In the example cited, we suggest the loan continues to be reported as Owner occupied until such time as the loan agreement is either formally revised (and in effect a new contract created) or a new contract is issued. This might happen for example if the borrower decided to let the property on an ongoing basis, and the lender formally required a new loan contract. In which case it would no longer be an RMC (buy to let is generally not a RMC: see MLAR Guidance for E6.2) and would then be reportable against BTL at E6.2. But in a temporary letting situation (where the borrower expects to re-occupy the property) a lender may well not formally require a new contract.

Q12 How to report "number" of advances in situations involving stage payments and further advances? A series of five related questions, shown below as a) to e) .

The firm asking this series of related questions noted: If a new advance has completed, and there has also been a stage payment/payments within that same quarter, the MLAR Guidance states at E1-6 (first paragraph) '... *separate*

advances (e.g. stage payments) made in the period on the same mortgage should count as a single advance for the 'number' column in sections E3, E4, E5 and E6'.

a) If the advance was reported in the previous quarter, but a stage payment or indeed more than one stage payment was made in the period under review, should the number count be '1' for each quarter?

- Yes, this would be the correct reporting treatment

b) If the advance was reported in the previous quarter, but the advance was cancelled during the quarter under review, should the number for the quarter under review reflect this (i.e. deduct 1 from the number count for the quarter under review)?

- No. Only report actual advances. "Cancelled advances" (presumably reported under repayments in D1) should not feature in "gross advances" in D1 or in E3, E4, E5 or E6.

c) If an advance was completed in the reporting quarter, and also completed a new further advance application (not a stage release) in the same reporting period, is this to be reflected by a count of 2?

- Further advances are more complicated, since they appear as a separate item in E6 and they are also arguably distinct from the situation briefly referred to in the first paragraph of the MLAR Guidance on E1-6 (which implies the need to amalgamate staged payments on a single loan, rather than separate loans which is effectively what a further advance is).

- The 2004/79 Handbook Instrument (issued in late Oct 2004) updated the treatment of Further Advances (FA), such that FAs on buy-to-let (BTL) and lifetime mortgages are now to be reported against these line items and not against the FA line at E6.3

- Thus, for consistency of treatment, it would be reasonable to treat the FA as a separate loan throughout E1-6. That is count '1' for original advance, and a further '1' for the FA. This would also match the treatment when reporting balances outstanding, in for example columns 3 and 4 of table E(2), where FA balances are reported separately at least for loans other than BTL and lifetime mortgages.

- So, in the example quoted, and following the above treatment:
  - if the FA is on a loan originally for house purchase, then report the FA against line E6.3 with a count of '1' there, and a count of '1' against the 'original' loan (ie advance made in same quarter) reported at E6.1.
  - but if the FA is against an 'original' BTL or lifetime mortgage made in the same quarter, then report it within E6.2 or E6.6. In either case, count '1' for the original loan and a further '1' for the FA, for consistency of treatment

- However, we realise that the first paragraph of the guidance could be interpreted to mean that a lender should combine the original loan and the FA made in the same quarter, and treat with a count of '1'. This would be an acceptable treatment. The difference in approaches is not likely to be material in terms of the "numbers", since few loans in practice are going to be subject to a FA in the same quarter.

- It is therefore a matter of choice for the lender, and systems implications may have an influence. But the first method outlined above would be our recommendation.

d) The firm splits accounts where the customers may require, for example, part of the loan on one scheme, and the other part on a different scheme (particularly relevant where portability is being used from their previous mortgage). Two accounts will be completed. Should this be reflected as a count of 2 or as they originating from the one application should this just be a count of 1?

- It is theoretically possible that the two accounts might be of a different legal type eg one regulated and the other non-regulated. In which case they both get treated separately, and clearly each should count as '1' for their respective loan types
- but if they are of the same type, then we would expect them to be treated as one loan and counted as '1' for numbers in section E

e) The same principle applies as in d) above. One application but where part of the loan may be on an interest only basis and part on a repayment basis. Two accounts will be created. Should the count in E4 By Payment Type reflect 1 in each band? Alternatively, would this be reflected in E4.3 'combined'?

- Treat as one loan (ie count as '1' for numbers); and yes, in section E4, the loan should be classified as "combined" and reported against E4.3

Q13 How should we report the number of accounts in section E4 of the MLAR, given that it is only one mortgage made up of a number of sub accounts with each account potentially being on a different product, interest rate and repayment type?

The firm asking the question provided further background, along with an illustration:

- *The firm can potentially have a number of accounts for one customer, a primary account, one or more secondary accounts and a further loan account. Primary and secondary accounts generally complete on the same day and just accommodate a customer who wants to split the advance amount on different products and/or repayment types. If a customer*

requests additional borrowing at a later date, this is also set up on a separate account, with a separate product and repayment type.

- *Customer Mr Smith:*
    - *Account 1: (primary), 5.29% fixed rate, repayment mortgage, £50,000, completion date 1st Jan 05*
    - *Account 2: (secondary), 4.74% tracker, interest only repayment type, £40,000, completion date 1st Jan 05.*
    - *Account 3: (further loan), 5% fixed rate, repayment mortgage, £20,000, completion date 30th Jan 05.*

The general approach is to treat loans with sub accounts as a single loan for "number of loans" purposes, except where this is not possible because of different legal types (eg if part is regulated, and part non-regulated) or where further advances are involved.

In the example quoted: in E4 the correct treatment would be to classify the overall loan against E4.3 Combined, as this is the intended category for the mixed interest/repayment situation described, with a count of "1" in the number of loans column.

Q14 How do we report the number of accounts in section E3 to E6 for instalment releases? Do we just include the account in the numbers when the initial amount is advanced? Or each time an advance is released?

The answer for "numbers" is that the staged released advances should count as a "1" in each quarter when they are advanced. So if a loan for £100k is released as follows the numbers are as indicated:

- Qtr 1: initial advance 50k: Count is "1"

  If there is also a staged advance on top of this in Qtr1, then add the £amounts together, and report the number of loans as "1" for number of advances

- Qtr 2: staged advance of 10k: count as "1" for number of advances

  If there are two or more staged advances in Qtr2, still show as "1" for number of advances

- Qtr 3: same principle etc.

Q15 How to report balances outstanding on Further Advances in E6?

The firm asking this question noted: *section E6.3 on Further Advance requires number/amount of further advances and number/amount for balances outstanding. As an example the firm provided the following scenario spanning events over four notional reporting quarters Q1 to Q4:*

- *Q1 - New regulated completion FTB - we will record advance and balance outstanding under E6.1*
- *Q2 - No Changes on the loan - we will record balance outstanding under E6.1*
- *Q3 - Regulated Further Advance issued - We will record the further advance in E6.3 and the original loan in 6.1 FTB*
- *Q4 - No Changes on the loan - We will record the total loan balance outstanding under E6.1?*

The intention in E6.3 is for further advances reported here (which, following updates in Handbook Instrument 2004/79, now <u>excludes</u> further advances on Buy to let and Lifetime mortgages) to continue to be reported in columns 3 and 4 in subsequent quarters. But this only applies where it is possible to separately monitor the balance outstanding on the further advance over time.

Thus in the example given, at Q4 we would normally expect the balance outstanding on this further advance to be reported in columns 3 and 4 of E6.3 .

However, in circumstances where a separate account is not established for the further advance, it will not necessarily be possible to separately report the balance outstanding on the further advance. Thus it would be acceptable to report the balance outstanding against the category of the initial mortgage.

Q15a Are we allowed to adopt the approach given in the final paragraph of the answer to Q15 (ie report the balance outstanding on the FA against the category of the initial mortgage), despite the fact that our system does hold FAs as separate accounts?

Since some firms will simply not be able to separately report continuing balances on FAs (eg because there is no separate account established for the FA), we are clearly going to experience "mixed" reporting in E6.3.

As a consequence we need to be neutral as to whether a firm, which does hold FAs as separate accounts, decides to report FA balances separately in E6.3 or combined with the original loan. This is because, as we have realised, the separate recording of a FA in a sub account does not necessarily mean that a

firm will be able to separately monitor all of the flows (eg repayments of principal, interest, etc) and allocate them at the sub account level. This is likely to be a particular problem if a borrower makes a single payment to cover all sub accounts. So the answer to the question is "yes".

Q15b If we are in a position to monitor Further Advances (FA's) separately on line E6.3, does this imply that we also need to include the FA number and amount on one of the lines in each of sections E3 to E5 for the total lines of each section to agree.

The numbers and £amounts in each of the "total" lines for sections E3, E4, E5 and E6 are expected to agree. So the figures on numbers and £amounts for FAs will need to be included on a consistent basis in each of the sections E3 to E6.

Q16 How to report lifetime mortgages without headline interest rates?

The firm asking the question noted:

- *Our Lifetime Mortgage product is not a roll-up and therefore does not have a headline rate of interest applied to each new contract. Instead for a given cash advance we calculate the charge we need to place on the customer's property by way of a lifetime mortgage. The charge is a fixed amount, repayable whenever the customer dies and the relationship between the cash advance and the amount of the mortgage charge is governed by the customer's life expectancy and the charges we would allow for over this period.*
- *As such we are not sure how to complete information on interest rates in D3 and also on income multiples and LTV in E1/2.*

Our advice was as follows:

- We think the approach to adopt here is to make use of the "expected term of the loan in years" which, under MCOB 9.4.10, is part of the information made known to the borrower, and is hence available for use in respect of each loan. Using this figure, it is then possible to work out for each loan, the implied interest rate that has been used in deriving the amount repayable at the end of the loan (ie on death).
- It is the rate (r), which at compound interest, when applied to the loan (L), results in the amount repayable on death (A) after an expected term of years (n): that is, where A= L {(1+r/100) raised to the power n}
- The MLAR Guidance for E1/2 (at (iii) Other) indicates that lifetime loans should be reported against the "Other" sub-category of Income multiple.
- For calculating the LTV, the loan is known, as is the current valuation of the property, so the LTV value can be computed.

Q17 On a Lifetime Mortgage product which will provide a borrower with either a lump sum, or lump sum plus monthly income, or monthly income only, do we report all of these in E6.6?

Yes. The original lifetime mortgage advance, plus any drawdowns in that same quarter, should be reported in E6.6 . Any drawdowns in subsequent quarters should also be reported in E6.6 (and also included in other figures for advances elsewhere in the MLAR)

Q18 How should bridging loans be classified as to 'purpose' in E6?

The answer provided was as follows:

- E6 is intended to capture the principal purpose of the loan at the time it is made.
- In the case of a bridging loan, it is not intended that a lender should attempt to identify the ultimate purpose of the loan, since that will only be known when the bridging loan is replaced by a long term loan
- What is appropriate however, is for the bridging lender to identify the purpose (in an E6 context) of the bridging loan itself.
- For example, it may be that the bridging loan is either being secured on a borrower's existing property (in which case it might be coded against E6.7 Other), or is being secured against a new property (in which case code against House purchase or buy to let). Such details should be known at the time of granting the loan.
- However, in the absence of specific guidance in the MLAR on the treatment of bridging loans in E6, it is likely that firms will follow one of two approaches to classification:
  - treat the loan as per normal advances, and classify each bridging loan to what seems the most relevant category in E6.1 to E6.7 depending on the circumstances of each individual case
  - alternatively, a firm may interpret the first sentence of E6 "This analysis is to identify the principal purpose of the loan..." , as meaning that since a bridging loan is only a short term loan its "principal purpose" is really to provide a short term funding facility before a longer term mortgage is obtained etc. As such, it would be reasonable to infer that an appropriate categorisation in E6 could be "E6.7 Other"
  - accordingly, we would not have any difficulty if a lender were to classify all of its bridging loans to E6.7

Q19 In Section E4.4 guidance notes, it states that "secured overdraft facilities" are to be included. Is this correct, given that the guidance notes state that balances in E1-6 are to agree with balances in D1 column 7 that excludes overdrafts?

The reference in section E4.4 of the MLAR Guidance to "secured overdraft facilities or secured credit cards" is incorrect. This text should have been removed when the Oct 2004 changes were made to the form and guidance, at the time that the treatment of overdrafts in section D was changed. So please disregard this text. In due course we will amend the guidance notes.

Section F: Arrears

Q1 How should we report on Arrears in section F, if the loan balance is made up of regulated and non-regulated elements?

The firm asking this question provided an example and two possible treatments: *For example, we have a loan with 3 accounts secured on the same property:*

loan a/c 1 original loan £75,000 - unregulated pre 31/10/04
loan a/c 2 further adv £20,000 - regulated Nov 04
loan a/c 3 personal loan £5,000 - unregulated pre 31/10/04 (does not meet criteria of a RMC)

and the firm suggested the choice lay between:

- *Amalgamate all balances (re MLAR Guidance for "F1 to F4" which indicates where more than one loan secured on a single property, these should be amalgamated where possible, in reporting of arrears cases) - but which section would you put the balance in regulated or unregulated?*
- *Split out the regulated and non regulated elements but this would mean that we are overstating the number of arrears cases*

The answer provided was as follows:

- The treatment of sub accounts in section F should follow the same treatment as adopted elsewhere in the return, which in turn will need to take account of the points made in MLAR Guidance: Introduction, Para 8 (iii).

- If this results in the sub accounts still being treated as a mix of regulated and non-regulated, then the regulated elements should be reported in section F under the regulated items, and the non-regulated elements reported separately under the non-regulated items.

- Numbers of cases: while there could therefore be one case appearing in each of regulated and non regulated, this will be no more than a reflection of the number of separately regulated elements, and is an inevitable consequence of having the regulated/non-regulated categories.

- The reference in the question to *MLAR Guidance for "F1 to F4"* and combining loans, only applies where loans are of the same type. Thus if there were 4 sub accounts with each related to regulated loans (ie actual or treatable as such), they could be treated as "one" for reporting "Number of loans".

- The arrears % band should be worked out on the loan balance which is the sum of sub accounts of the same type (eg all those that are being reported as regulated)

- In the example, loan a/c 3 is quoted as being a personal loan. Personal loans only count as mortgages if they are secured on land and buildings, and they can be regulated mortgage contracts. (If they are unsecured loans, they are reported in A3.5 (and B2.5) but nowhere else in MLAR.) If they are secured, they are potentially no different to loan a/c 1, and could be treated in a similar way.

- Without further details of the example loan a/cs, it is difficult to give definitive advice on the appropriateness of combining them. For example if loans 1 and 3 are secured loans, which otherwise satisfied the specific requirements of a RMC at the time they were entered into then, following the MLAR Guidance at paragraph 8 (iii) (a) of the Introduction chapter, they could be combined with loan 2 and all treated as one. But if the personal loan is a second charge loan then this element would remain "non regulated", whilst if unsecured it falls out of D, E and F altogether (as mentioned in previous bullet)

Q2 The MLAR guidance indicates that Section F does not need to be submitted for the period April to June 2005. When subsequent reports are submitted, how far back do we need to look for capitalisations?

The firm asking this question noted: *theoretically an account could have been capitalised several years ago and never performed and would therefore need to be reported using the original arrears balance - this would be extremely difficult to derive.*

We would draw your attention to some comments made on Arrears reporting and timing of system changes in PS04/9: paragraph 6.8 (response on category (b) in particular).

This reference to not needing to have modified systems for arrears monitoring in place before 1 April 2005 implies:

a) It is not an obligation : some firms may choose to put modified arrears monitoring systems in place from an earlier time

b) The 1 April 2005 reference, above, however implies that capitalisations done before that date do not need to be taken into account for the purposes of section F reporting. That is, there would appear to be no need to look through such arrangements and assess arrears as if capitalisation had not taken place: any arrears on such cases would be the amount left after capitalisation. Hence only capitalisations made on or after 1 April 2005 theoretically need to be subject to the criteria set out in section F (ie section 3 of Guidance Notes for section F) on capitalisation and fully performing. Some firms however may choose to apply the new scheme from an earlier date but they are not required to do so though.

Q3 Can you clarify the basis for calculating the 'Performance of current arrears %' that we are required to report in Section F?

The firm asking the question noted:

- *Regarding the 'Payment Received' amount used in the calculation, quite often customers will pay over the amount due when trying to clear the arrears they have on the mortgage account. This is an acceptable policy within the firm and we will accept overpayments where customers are in arrears.*
- *In Section F, subsection 6.1 (ii) of the guidance notes, it states the following: "Therefore, in compiling aggregate payment received figures (as part of the payment performance ratio) the contribution from an individual loan in arrears should be limited to no more than the 'payment due' amount."*
- *Does this mean for reporting purposes, that for every case that overpays we have to cap the payment received amount to the payment due amount, and in effect constrain the performance measure for an individual case to 100%?*

The answer provided was as follows:

This specific guidance needs to be applied at the level of each arrears case, and if the payment received exceeds the payment due on that case, then for MLAR reporting purposes the payment received amount for that case needs to be restricted to the payment due amount. If this approach were not followed, then a firm would be reporting overpayments on one case that compensated for underpayments on other cases, and hence understating underperformance on those cases. Using the approach set out in section F, we get a more meaningful performance measure than we would do otherwise.

If this methodology is followed at individual case level, then the overall ratio entered in respect of all cases on a particular row of F1 to F4 will then be correctly computed.

On this basis, the percentage for a group of loans will not then exceed 100. The validation rules prevent an entry greater than 100 from being entered. However, we would not expect to see "100%" reported much at all, the exception perhaps being where the performance measure on a particular row was based on one or two loans each of which fully performed in the quarter. In contrast, where the performance measure relates to a large group of loans, we would expect a performance significantly below 100 given the reality of arrears case performance (and no individual case contributing more than its constrained maximum as described above).

Q4 The validation rules for the performance measure % in F1 to F4 suggest that a zero entry is not expected if there is a balance reported in column 6. But isn't it possible that none of the reportable cases have performed in the quarter?

The approach to entering a "zero" performance ratio in F1 to F4 is:

(i) there is no problem with this on the possession lines, where such a result is not unexpected

(ii) but on other lines, where there is a balance in column 6, we would normally expect a performance measure greter than zero. Hence the validation rule that it should be greater than zero for such lines. This will be relevant in the vast majority of situations in these sections of F and accordingly is a helpful test to ensure a firm does not miss out a performance figure. In exceptional cases however, especially if there are only one or two cases in a line for that measure, it is possible that none of them will make any payments in the quarter, resulting in a calculated ratio of zero. Because of the validation rule however, it will be necessary to enter such a "zero" as 0.01 in order to "pass" the rule.

Q5 Can you clarify how part capitalisations should be reported in section F?

The firm asking this question sought clarification using three examples.

Example 1: Account is £5000 in arrears and is currently reported in the 2.5<5% category (in F1-4). The customer then capitalises £2000 of the arrears leaving them £3000 in arrears, and makes no attempt to repay the outstanding £3000 arrears. Should the account continue to be reported in 2.5%<5% category until it has fully performed for six months?

- In this example, the lender agrees to add the £2000 to the balance outstanding, so that the loan is now formally £2000 greater than before (with £3000 still in arrears) and the borrower is paying a regular monthly payment that has been revised to reflect the now larger loan size

- However, as the borrower is making no attempt to pay off the outstanding £3000 arrears, then this type of case would not be regarded as falling within the definition of "capitalisation", nor as ever qualifying for "fully performing" under section F guidance. So it would also not be eligible for reporting any amount as being capitalised in F5.

- A loan in arrears cannot be considered as "capitalised", under section 3.1 of section F guidance, unless either
  - all arrears are added to the amount of outstanding principal; or
  - part of the arrears is capitalised and added to the amount of outstanding principal, and simultaneously the borrower repays the non-capitalised arrears over a shorter period of time (than the residual term of the loan), and which we have described in the guidance as "a shorter period ranging for example from 3 to 18 months"; or

    - none of the arrears is capitalised, but the borrower enters into an arrangement to repay the arrears over a shorter period of time (than the residual term of the loan), and which we have described in the guidance as "a shorter period ranging for example from 3 to 18 months"
- In the example quoted above, the "arrangement" does not satisfy any of these three alternatives
- As to reporting in MLAR, on the basis of the information provided in the example, the loan would simply need to be reported in F1 to F4 with the amount of reportable arrears being the extent of arrears at the quarter end (that is after any overpayments, but ignoring any capitalisations), and allocated to the arrears band applicable as if no capitalisation had taken place, that is based on the £5000 arrears. However, in the continued absence of any repayment of arrears, it would not qualify for removal from F1-F4, and hence there would be no amount reportable as capitalised in F5.

- The purpose of the guidance on capitalisations in section F is to ensure consistency and avoid distortions. Clearly if a firm arbitrarily capitalised parts of a borrower's arrears, and made no arrangements for effective repayment of the non-capitalised arrears over a suitable period, then this would distort that firm's arrears reporting in relation to our guidance and in relation to the way in which other firms were reporting (and who were following the reporting criteria in section F on capitalisations and fully performing etc). It would result in the understatement of the underlying arrears and would imply that a firm's underlying arrears position was better than in fact was the case.

Example 2: The same as the above, but the customer agrees to pay off the remaining £3000 arrears over a period of 18 months. At what time should the loan be removed from F1-F4 and reported in F5 (under cases capitalised in the quarter)?

- In this second scenario, the lender agrees to: capitalise £2000, and simultaneously allow the borrower to repay £3000 over a period of 18 months
- If this is the case, then this would meet our criteria for "capitalisation"
- Moreover, from the time this arrangement commences, if the borrower then fully performs for 6 consecutive months (that is meets the increased monthly payments taking account of the loan balance increase of £2000 on a normal commercial basis, and pays off the expected monthly amount on the £3000 arrears [presumably an eighteenth of £3000 each month]), then the lender should remove the case from section F1-F4 after that six month period and report the loan in F5 as being capitalised

- This case would not then appear in F1-F4 in subsequent quarters unless of course it later defaulted and went into arrears (but if so, taking note of the reporting treatment set out at section 2.8 of F)

Example 3: Account is £5000 in arrears and is currently reported in the 2.5<5% category. The customer agrees to pay off the arrears over 18 months. At the end of 18 months the arrears have been cleared, would the account continue to be reported for a further 6 months in the 2.5<5% category, then at the end of the 6 months (again assuming it is fully performing) would we report the case in F5 with the arrears amount at £5000?

- As the borrower is repaying all of the non-capitalised arrears over a shorter period (than the residual term of the loan) this type of arrangement is also regarded as an equivalent of "capitalisation" (section 3.1 of F guidance notes)
- But the fully performing assessment clock starts ticking as soon as this additional repayment arrangement is in place, not after the 18 month period ends
- The six month criterion therefore starts from that same point (ie as soon as the additional repayment arrangement is in place).
- So if the borrower meets the agreed additional repayments (that is at least one eighteenth of £5000 per month, in addition to the regular repayments on the loan principal) for 6 consecutive months, then the case would qualify for removal from F1 to F4, and the case would be reported as a capitalisation in F5
- As to reporting in MLAR <u>before</u> the case is removed from F1- F4: on the basis of the information provided in your example, the loan would simply need to be reported in F1 to F4 based on the extent of actual arrears at the quarter end.

In the above examples 2 and 3: what is the amount of arrears to be reported in F1-F4 and F5?

- Reporting of such loans while the arrangement is in place (but before the conclusion of a consecutive period of 6 months of fully performing), and the loan is reported in F1 to F4: the amount of arrears at the financial quarter end in column 5 of F1 to F4 should reflect the amount of arrears (ignoring any capitalisation) that then exists after accounting for any overpayments, since the arrears are being reduced each month through actual payments.

- Reporting of such loans in F5, (when the loan is removed from F1 to F4): the amount of arrears in field 4 of F5 should be the amount of arrears (ignoring any capitalisation) that then exists after any overpayments, since the arrears are being reduced each month through actual payments. Field 5 of F5 would be the loan balance outstanding: so if the loan was for £100,000 and arrears rose to £5000 before the arrangement, then the figure in field 5 would be £100,000 plus the residual amount of the £5000, that is after the amount paid off under the arrangement (presumably 6/18ths of either £3000 or £5000 respectively in the two examples).

Q6 Are all types of “arrangements” eligible to be treated as “capitalisations” in section F?

No, not every type of arrangement will be relevant, and only those that satisfy the specific criteria in section 3 of the guidance for section F will be eligible.

A loan in arrears cannot be considered as "capitalised", under section 3.1 of that guidance, unless either

- all arrears are added to the amount of outstanding principal; or
- part of the arrears is capitalised and added to the amount of outstanding principal, and simultaneously the borrower repays the non-capitalised arrears over a shorter period of time (than the residual term of the loan), and which we have described in the guidance as "a shorter period ranging for example from 3 to 18 months"; or
- none of the arrears is capitalised, but the borrower enters into an arrangement to repay the arrears over a shorter period of time (than the residual term of the loan), and which we have described in the guidance as "a shorter period ranging for example from 3 to 18 months"

It is perhaps worth emphasising, as in section 3.2 of section F, that "The decision to 'capitalise' (or treat as if capitalised) is a business decision between the firm and the borrower". That means it must be a conscious decision by the firm to treat a borrower in this way.

That implies that any such treatment of an arrears case needs to be explicitly classified as such in any monitoring of arrears, since not all cases involving “some kind of arrangement” will necessarily be ones that a lender will want to regard as a 'capitalisation' (or equivalent). For example a lender might wish to "test" a borrower's willingness/capacity to reduce an arrears position (by some degree of modest overpayment) initially, before deciding to go for a full or partial capitalisation (or indeed no capitalisation, but repayment of arrears over a defined period).

Q6a Where an eligible Arrangement case (involving payment of arrears over a set period) has made satisfactory payments for 6 consecutive months and has therefore become performant this quarter, but on which at the reporting date there are arrears outstanding of less than 1.5% of the loan balance, should the loan be reported (i) in F5 as a performant case or (ii) not in F at all since the arrears are now below the general 1.5% threshold for reporting section F?

By “eligible Arrangement case” is meant a case that satisfies the criteria set out in Q6 and is eligible to be treated as a “capitalisation” case. In this case, the borrower is paying off all past arrears over a set period. The approach to reporting such a case is based on the following:

- cases of this type can be "removed" from F1-F4 in two ways

- after they perform for 6 consecutive months, at which point :
  - if remaining arrears are above 1.5%: they would otherwise stay in F1-F4 unless we had the "fully performing & removal from arrears" criteria in operation (as set out in section 3.2 (iii) of the Guidance on F), so the treatment is to report them in F5 since they are only being removed from F1-F4 because of those criteria .
  - if remaining arrears are below 1.5 %: they are no longer reportable in F1-F4 because the level of arrears is below the reporting threshold of 1.5%. Hence they drop out of F1-F4 without the application of the "fully performing & removal from arrears" criteria, and so should not be reported in F5.
- as soon as the level of arrears falls below the 1.5 % threshold. This could be after any time from 1 to 6 months. Again, they are not reportable in F5

See also Q5 in this section, and specifically Example 3, which deals with an example of a case involving repayment of all arrears over a set period.

Q6b When assessing an arrangement case for compliance with the "fully performing for 6 months" criterion, can we take in to account any flexible payment features attaching to the loan?

The firm asking the question noted that:

- Following capitalisation of arrears, a borrower would have to make 6 consecutive full monthly payments before being removed from the arrears figures disclosed in the MLAR. As the vast majority of our mortgage products have flexible features (i.e. allow for overpayments and subsequent underpayments), we could be faced with a situation whereby a borrower's total monthly payments within this 6 months period are equal to or greater than the sum of the expected payments, but may not necessarily have been made in equal instalments. For example, a borrower with a contractual monthly payment of £1k per month would have an expected payment pattern of 1-1-1-1-1-1. However, if they were to overpay and then underpay during the period, they could have payment patterns such as 1-2-0-1-1-1 or 2-2-0-1-0-1 without going into arrears. This would be allowable under the terms and conditions of their mortgage.

- Assuming that a borrowers total payments equal or exceed the expected payments in the 6 months since capitalisation and during that time the borrower had not at any point fallen back into arrears, am I correct in assuming that the 6 consecutive payments condition has been satisfied and that borrower can be excluded from the MLAR arrears disclosures?

The answer provided was as follows:

The guidance on "fully performing for 6 consecutive months..." needs to take account of the underlying contractual conditions attaching to the mortgage.

But what is key here, is that each monthly payment must individually satisfy the terms and conditions of the mortgage. Thus in the circumstances of a flexible mortgage, of the kind you mention, a borrower would need to meet

the minimum contractual (as specified by the terms & conditions) payment each month in the 6 month period (any failure in any month would then lead to the 6 month clock being restarted). If those mortgage terms and conditions permit such a borrower (who is in arrears) to vary monthly payments (including to overpay and perhaps even miss a payment), then the monitoring of the arrears case and its compliance with the "6 consecutive months fully performing criteria" would need to take such variations into account.

Hence, in relation to the question in your final paragraph, the fact that a borrower had paid in total an amount equal to or exceeding the 6 monthly payments, would not of itself guarantee compliance with the "fully performing for 6 months " criteria. For example: if a monthly payment had been missed (and such an option was not a part of the mortgage terms & conditions); or if in any month the payment was below the contractually expected minimum. However, providing your expression "the borrower had not at any point fallen back into arrears" was intended to cover these types of breaches of the contractual terms, then your assumption here would be valid.

Q6c Should those cases reported as being subject to an arrangement, in F5 column 7, exclude any arrangement case where the borrower is not up-to-date with the rescheduled payments?

No, we would expect a firm to report a case as being subject to an arrangement in F5, irrespective of its performance status. That is, it covers cases where the lender has entered into an arrangement (as we describe in paragraphs 3.1 and 3.2 of Guidance Notes) recognising that not all cases will be fully performing every month, so we would not expect lapses to result in reclassification (unless a lender formally cancelled the arrangement). Our reporting criteria go on to advise how such lapses should be treated (the 6 month clock restarts again) but we think these cases should continue to be treated as arrangements.

Q7 What is the basis for reportable arrears on a capitalisation case that subsequently defaults, when not all of the original arrears were themselves subject to full capitalisation?

The firm asking this question noted: *section 2.8 of the guidance for section F sets out the basis for reporting a subsequent default on a capitalisation case that has at one time been removed from section F1-F4 after satisfying the fully performing criteria. But how does the comment that "the previously capitalised arrears should not be reinstated as current arrears" apply to cases that did not involve full capitalisation of arrears?*

The answer provided was as follows:

The comment in section 2.8 that "the previously capitalised arrears should not be reinstated as current arrears" is meant to reflect a business practice as between the lender and the borrower, and to a lesser extent an aspect of loan account recording.

Thus the business practice is: once a lender has formally capitalised arrears (ie added to loan balance and created an enlarged principal etc), the borrower's "arrears" have formally been added to the loan and the borrower is no longer contractually regarded as having those arrears. (After such an event, some lender's systems will no longer be able to easily identify the "old arrears" in the event of a subsequent default: this is the aspect related to loan account recording.)

That is not the same however where a borrower is paying off "non-capitalised" arrears. In those cases, such amounts of arrears are not "capitalised" and they remain an outstanding obligation of the borrower repayable over a shorter period (ie shorter than the residual term of the loan, which is the period in the case of a capitalisation).

So in the case of a loan with non-capitalised arrears, we believe the correct treatment is for the loan to be reported in section F (at such time that it subsequently defaults) on the basis that "amounts of arrears" should reflect the full amount contractually owed by the borrower at that time, and not any lesser amount that might arise were the "residual arrears balance at the time the loan had met the six month test, and had been removed from reportable arrears" to be excluded. This fits with the guidance at section 2.8: since the arrears in such cases have not been "capitalised", there is no "capitalised arrears" to be considered for any possible re-instatement, as the amount of arrears on the loan remains a repayable short term obligation (and which is only reduced by actual overpayments made).

So, as an example, if the loan involved arrears of £5000:

- of which £2000 had been capitalised, and
- leaving non-capitalised arrears of £3000, which under the formal arrangement between lender and borrower were required to be paid off over say 15 months (ie £200 per month)
- and thus the residual non-capitalised arrears, after 6 months of fully performing and at the time the loan was removed from F1-F4, would be £1800 (ie £3000 less 6 months repayments of £200 a month)
- then in the event of a subsequent default, say 5 months after removal from F1-F4, the reckonable arrears would then be:
    - zero in respect of the capitalised arrears of £2000; plus
    - £1000 in respect of the non-capitalised arrears [this is the £1800, less 4 further payments of £200, before missing a payment in month 5; plus
    - the amount of arrears from the missed payment in month 5 (this might be the normal monthly amount on the whole loan and/or the missed £200)
    - which when added together, and if amounting to 1.5% or more of the loan balance, would mean the loan was again reportable in F1-F4

Q8 If a capitalisation case qualifies for removal from F1-F4 during the reporting quarter, but subsequently defaults before the same reporting quarter end, should it still be reported in "F5 Capitalisation of arrears cases in quarter"?

Using as a basis, the guidance in section F5, under the subhead "Capitalisation of arrears cases in quarter", the answer to this is that if such a loan is still reportable in F1 to F4 at the end of the financial reporting quarter, then it does not qualify for inclusion in F5 since as the guidance says it has not been "removed" from the figures which now appear in F1-F4 (even though the case satisfies the other criteria for fully performing). Whether such a loan is still reportable in F1-F4 will depend on the level of qualifying arrears at the quarter end: taking account of section 2.8 criteria, and the amount of new arrears arising from the fresh default (see also Q7 for an example).

Q9 In the case of possession sales in F5, should "balance outstanding" take account of sale proceeds?

In the context of possession sales during the reporting quarter:

- balance outstanding is commented on in section F5, in the second paragraph
- under the sub-head "balance outstanding", it explains that balance outstanding "is as defined in section F/1 paragraph 1.1 [NB: this appears on the 2nd page of section F guidance notes] .
- it also mentions "including in the case of properties sold the costs of sale where these have been debited to the borrower's account"
- although it mentions that "it should be the balance at the end of the quarter", this needs interpretation if a loan has ceased to exist during the quarter, as for example with a property in possession that was sold during the quarter. If the loan is still in existence at the reporting quarter end, then it is the balance at that date, but if the loan has been taken off the books sometime during the quarter, then the balance outstanding is the balance on the loan (ignoring sale proceeds) immediately before it was taken off the firm's books

Thus for loans where the underlying security has been taken into possession and sold, the "balance outstanding" means the amount of the borrower's loan, <u>but disregarding any revenue or proceeds from the sale</u>. It is the borrower's indebtedness to the lender therefore, taking account of all the potential items mentioned in section F, paragraph 1.1, (including any suspended interest not included in the balance sheet [see last sentence of 1.1]), and including the extra item from the third bullet above, namely "including in the case of properties sold the costs of sale where these have been debited to the borrower's account".

So if for example :

- the original loan was for £100k, a few years ago, and on an interest only basis
- on a property then valued at £120k, but say now valued at £150k
- with accumulated arrears of interest, miscellaneous debits/charges of say £10k up to the time when the property is taken into possession and sold,
- and the property is possessed and sold for £125k (distress sale at less than market value) with sale costs of £6k being charged to the borrower's account
- the "balance outstanding " in F5 column 2 is £116k [original 100, plus arrears of 10 and sale costs of 6]
- but the sale proceeds are not relevant for the purposes of F5. {The borrower would presumably receive the net proceeds of £9k, ie sale proceeds less loan indebtedness, that is £125k less £116k}

Q10 When should a possession case be removed from F1-F4?

The following comments provide details:

- a loan where the property is taken into possession should remain in F1 to F4 (eg at F1.6, F2.6 etc) until either the "possession" is reversed (a rare but theoretical possibility) or the underlying property acting as security is sold
- once the security is "realised", and the property sold, the loan no longer has the same characteristics. In particular the loan is no longer secured on property.
- once the property has been sold, the loan should be removed from F1 to F4 and reported in F5 as a possession sale.
- the basis for reporting the balance outstanding in column 2 of F5 is dealt with in the previous Q/A
- thereafter, the loan is not reportable in section F at all
- any residual debt owing to the firm (ie borrower's full loan/debt obligation to the lender, less the amount of sale proceeds from the sale etc) is no longer a "secured loan", and a lender would probably carry this in its balance sheet as "other assets". The lender then has the choice to write this residual debt off, or seek recompense from the borrower or third parties (eg if mortgage indemnity policy is in place)

Q10a Can you clarify whether sales shortfall accounts, arising from possession sales, should be reported as secured loans (regulated or non-regulated) or other loans, as the loan is no longer secured by a property? The reference to “probably” in Q10 of section F suggests there may be alternative treatments.

The answer provided was as follows:

- In Q10 we referred to: "any residual debt owing to the firm (that is the borrower's full loan/debt obligation to the lender, less the amount of sale proceeds from the sale etc) is no longer a "secured loan", and a lender would ***probably*** carry this in its balance sheet as "other assets". The lender then has the choice to write this residual debt off, or seek recompense from the borrower or third parties (eg if mortgage indemnity policy is in place)"

- On that basis, the word "probably" was used because it was previously recognised that accounting opinion as to classification was not hard and fast.

- Certainly the loan is no longer secured. So it should not be reported as Regulated or Non-regulated. Also given that it is not secured, it cannot be classified as "Other secured". That means it is not reportable in sections D onwards.

- This leaves A3.5 Other loans (which includes unsecured), and which ties back to A1.6, or "other assets". We are neutral as to which of these is used, and could not say one is obviously preferable. At the end of the day it really depends on how your auditors see it being reported in the balance sheet. So the choice is a matter for the firm, in conjunction with advice from its auditors

- For further detail on what might go in A3.5 please see Q2 in section A of FAQ document (approx page 15)

Q11 If a loan is maintaining its revised payment schedule under a formal Arrangement that qualifies to be treated as "a capitalisation", but the loan attracts fees in the meantime, does this count as a temporary increase in arrears (per section 3.2 of F), thus requiring the lender to start the 6 consecutive month monitoring process again?

The firm asking this question noted: *It is common practice to charge a "monthly arrears management fee" for each month that the loan remains in arrear. Thus as an example:*

- *1st Jan - arrears balance = £1000, formal arrangement established to collect current contract payment plus £200 towards clearing arrears*

- *31st Jan - monthly arrears management fee raised for £30, arrears balance now £1030 i.e. a "temporary increase"*

- *1st Feb - borrower correctly pays current contract payment plus £200 towards arrears, arrears balance now £830*

- *thus the borrower is maintaining the revised payment schedule, but the arrears have temporarily increased.*

The answer given was as follows:

Fees (as described in your example) would appear to be part of the borrower's total debt (see section 1.1 (iii) in section F of the guidance). As such, they should be considered as a part of the arrears situation when the revised repayment schedule is being established:

- the impact of the monthly fee on the revised payment schedule will depend on whether the lender requires the fee to be repaid monthly or allows it to be added to the loan and repaid over the residual term of the loan (see section 2.3 (iii) of section F)

- thus if the fees are properly included in a revised payment schedule, then we would not regard them as giving rise to a temporary increase in arrears

- for example , using your illustration, and modifying it for monthly fees, it would appear that a fully inclusive repayment schedule could be say:
    - arrears 1000; repayable over 5 months ; plus 30 fees a month, giving a monthly repayment of 230
    - or, assuming borrower can only manage 200 a month, then it will take 6 months to pay off arrears of 1000 plus 5 or 6 monthly fees

Looking at this type of situation more generally, the following comments on dealing with arrears charges are also relevant:

- charges such as fees need to be handled, in terms of arrears monitoring, in a way that recognises when the fee is contractually payable. Normal commercial practice, and perhaps even a lender's terms and conditions, would normally recognise that there needs to be a time interval between raising a charge and its expected payment eg within a week, a month etc
- only payments that are contractually overdue should be "counted" as being in arrears (see section 2.3 of section F Guidance)
- thus the fact that a charge has been debited to a borrower's account, would not of itself constitute an increase in arrears at that point in time. Rather, it might give rise to an increase in reckonable arrears if it was not paid by the time it was contractually due.

Q12 How should we classify an arrears management case under F5 if the borrower does not accept our proposals for a concession or an arrangement?

Since in effect, there is neither a concession nor an arrangement actually in place, as the borrower has not agreed to or accepted such an offer by the firm, we consider that such cases should be classified as 'No concession/ arrangement', and thus included in the final column of F5.

Q13 How should we determine the amount reportable as "arrears" where the loan conditions are such that, in the event of a default, the full loan is repayable on demand?

The answer provided was as follows:

- The amount to be reported as arrears is the amount overdue as at the date of making the formal demand (as defined in section 2.1 and 2.2 of section F of the guidance notes). For example, if arrears amounted to £10,000 on a loan of £200,000 the figure to be reported as arrears is £10,000 (even though, in the case of a formal demand having been made, the full debt of £210,000 is contractually repayable on demand)

- If a firm subsequently agrees to no longer enforce the "on demand" condition, and instead decides to capitalise some or all of the arrears, then the case should continue to be reported as an arrears case in section F of MLAR until such time as the case satisfies the "fully performing" for 6 consecutive months criteria for capitalisation cases, as set out in section 3.1 and 3.2 of section F of the guidance notes.

Q13a For a loan where no periodic repayment is expected until the loan facility or fixed term expires, should we treat the amount of "arrears" in F1-4 columns 2 & 5 as being the whole loan amount then due?

The firm asking this question further noted:

- This type of loan, such as a building finance case, is where the loan involves: interest being rolled up, no instalments being made, and the loan repayable in full (with interest etc) when the facility or fixed term expires
- As such, since the whole loan (including rolled up interest) falls due when the facility or fixed term expires, our thinking is that should the borrower default then the "arrears" for columns 2 & 5 could be taken to mean the full loan amount including interest.

The answer provided was as follows:

In line with our previous advice in Q13 of section F, and for reasons of consistency across firms in reporting the amount of pure arrears in columns 2 & 5, we are advising firms in this type of situation to only report the amount of interest that is overdue when the loan facility or fixed term expires.

Q14 We understand the FSA does a reconciliation check on possessions in F and H. Can you explain?

For possession cases, we look at stocks and flows to see if they appear to reconcile between adjacent quarters. Here we look at:

- possession cases at the end of the previous quarter,
- deduct possession sales in say F5
- add new possession cases this quarter
- and then compare the result with the possession cases at the end of the current quarter.
- The difference is the number of other cases that have been "removed" from possession figures reported at the end of the previous quarter. Removals can be for a variety of plausible reasons (eg a case improves and goes out of possession etc).
- Where this implied removal figure is either very large or negative, we believe there may have been an error in one or more of the figures reported, and we ask a firm to provide an explanation, and where necessary to submit revised figures.

In some cases, the explanation provided indicated that another factor was responsible for the reconciliation difference: namely possessions taken and sold in the same quarter, where in some cases a firm had not included them fully in the reported figures. This is the subject of another QA below.

Q15 How should we deal with possessions where the property is taken into possession and sold in the same quarter?

Our understanding is that some uncertainty has arisen as a result of the subhead for F5 being “Those cases no longer reported (ie not included in F1 to F4.7)” since, in the case of a possession taken and sold in the same quarter:

- such a case would not have previously been included in F1 to F4 in the previous quarter
- and neither would the case be reported in F1 to F4 (columns 4-6) of the current quarter, since it had been sold during the quarter and was not in possession at the end of the quarter.

Moreover, if a firm had no properties in possession (PIPs) at the end of the quarter, but had taken and sold several cases in the quarter, it would face a validation rule error were it to report new cases in say F1.6 (columns 1-3) and zeroes in columns 4-6.

- this is because there is a validation rule that requires cols 4-6 to be at least as much as cols 1-3 (in most cases this is quite logical, but obviously for a PIP taken and sold in the same qtr it appears less so). So where a firm only has PIPs taken & sold in same quarter to report, it would need to report it in both cols 4-6 as well as cols 1-3

- as such, we and the firm included, would both need to interpret the figures in say F1.6 columns 4-6 as representing "normally balances on cases in possession at the qtr end but, in the case of a possession case(s) taken into possession and sold during the qtr, it may also include or entirely represent balances on such possession cases prior to sale"

As a result of the above, our advice on treatment of **cases that are taken into possession and sold within the same quarter** is as follows:

- include all such cases as 'new possessions in the quarter' in for example F1.6 columns 1 to 3
- where the corresponding end quarter figures in columns 4-6 of for example F1.6 are less than those reported in columns 1-3 then, because of the currently applied validation rules, it will be necessary to modify the reportable entries in columns 4-6 so that they are in each case not less than those in the corresponding fields of columns 1 - 3. *(In due course it may be possible to amend the validation rules to avoid such distortion, but we do not know how soon this will be achievable.)*
- include all such cases as 'possession sales in the quarter' in for example F5.1 columns 1 & 2

Q16 How should we report 2nd charge possessions?

For MLAR reporting, it is worth noting that a 2nd charge loan is a non-regulated loan, and so even where the same lender makes both 1st and 2nd charge loans to a borrower on the same property, the two loans will be reported separately (including for arrears and possessions purposes) so when "numbers of loans/loan accounts" are concerned each will count as "1".

There are two broad types of situation with 2nd charges:
(a) where the firm (say firm A) has originated a 2nd charge loan itself
(b) where the firm (say firm A) has a 1st charge to a borrower on a specific property, and another lender (say firm B) has a 2nd charge loan on the same property.

In (a), the firm A should report this as a possession since the firm has initiated the possession itself. The firm should also report it as a possession if it becomes aware that either the 1st charge lender (or a 3rd or subsequent charge lender) has obtained possession.

In (b), and assuming the other lender firm B (holding the 2nd charge) has initiated possession, then firm A should, if it becomes aware of this event, still report its own 1st charge loan as a possession since in practice that is the status of its own loan.

In some instances the 2nd charge lender will not be regulated, so there is no duplication for MLAR aggregates. In other instances, where both lenders are regulated, there is potential for some duplication: however in practice this may not arise, not least because one of the firms may not realise that the other has taken possession, or only becomes aware when the property has been sold, at which point it may not be reported in its MLAR because it was not able to report it as a possession in its latest MLAR. There is however the potential for some very limited duplication, but we cannot avoid it happening.

Section G: Mortgage Administration

Q1 What type of loan administration is reportable?

The trigger for reporting any potential loan administration activities is whether a firm has an authorisation for loan administration. So here, assuming the society has such an authorisation, it potentially needs to complete sections G and H of MLAR:

- However if it only administers its own loan book, and doesn't have any off-balance sheet loans to administer, then it merely ticks box G0, and does not complete sections G1 and G2 or table H.

- But if it carries out any loan administration for other firms, then this should be reported in table G. This applies irrespective of the regulated status of the other firm. This is because we are interested in the range of loan administration carried out by any firm that is an authorised administrator. For this reason, table G collects information on loan administration, distinguishing between whether it is undertaken as a "principal administrator" or as an "other administrator"; and also split by regulated and non-regulated loans.

Q2 The firm acts as agent in carrying out specified mortgage administration activities for ABC City Council. From 31 October 2004 it is our understanding that such a City Council, in the capacity of a Registered Social Landlord, is not required to have FSA authorisation or a part IV Permission for either a mortgage lender's activity or a mortgage administrator's activity.

In view of this, and the fact that the loans are not deemed to be (nor would appear to be capable of becoming) regulated mortgage contracts and no further advances are allowed by the local authority, we query if there is a requirement for the firm to complete MLAR sections G & H?

On the basis of the information provided, the firm needs to report the loans that are administered for the City Council as follows:

- Report the activity against G1.1b and G1.2b, ie against “Other firms”

- Report under the Principal administrator role, then

- If the loans are pre 31 Oct 2004, then report under non-regulated

- If there are any loans made after 31 Oct 2004, or variations made to existing loans such that a new contract is created, and they are such that they satisfy the conditions of a regulated mortgage contract (see paragraph 4(iv) of Introduction chapter of MLAR Guidance), then report under regulated loans.

- Our view is that if the loans made by a Local Authority (LA) are such that they satisfy the conditions of a regulated mortgage contract, then such loans are regulated mortgage contracts, and the LA is carrying on a regulated activity, albeit not one for which it needs to be authorised. If the LA then out sources the administration of these regulated mortgage contracts, then the administrator needs to be authorised to undertake this activity.

- Also you will need to report any loans noted above, under section G2.2, and also in table H.

Q3 Firm XYZ provides specialist loan administration services to an authorised lender, and in particular to its special purpose vehicles (SPVs). Who should report on these SPVs in sections G (and H)?

The position on reporting is as follows:

- The authorised lender, but only if it is also an authorised administrator, will report its own SPVs at G1.1 c) and G1.2 c) under the "Principal Administrator" columns, and also in G2.3.

- Assuming the above applies, then XYZ would complete its own MLAR, with entries under the "Other administrator " columns of section G1. But we think the SPV loans administered should be reported against the SPV entries at G1.1 c) and G1.2 c). This is because they are SPV loans and not on-balance sheet loans of the lender.

- In G2, when reporting several SPVs of the same originating lender, we think it is preferable to aggregate all and report on a single line in G2.3

- If the condition in the first bullet does not apply however, that is the authorised lender is not also an authorised administrator, then the lender is not required to report its SPVs in G1 or G2. Instead, the regulated loans in the SPV will need to be administered by a third party that is authorised as a loan administrator. So if this were XYZ, and assuming XYZ is an authorised administrator, then XYZ would be acting as a "Principal administrator", and accordingly it would report the SPV loans under the "Principal administrator" columns of G1 against G1.1 c) and G1.2 c).

Q4 When a 3rd party loan administrator reports "number of loans" being administered for Firm A in G1.1, should this be on the same basis as Firm A reports "numbers of loans" for the same loans in its section E3-6?

The answer provided was as follows:

- there is merit in a loan administration firm reporting numbers of loans in section G on the same basis that the lender, for whom loan administration is being conducted, reports them in its own MLAR

- a lender will report numbers of loans in section E
- in section E, where a firm is able to separately record balances on further advances, then a firm will report a count of "1" for the original advance and "1" for the further advance. Similarly if, albeit perhaps rarely, a single charge supports two or more loans, then we would expect a firm to probably report them as "2" (or more) in "numbers of loans" in section E.
- but the two firms systems might use subtly different approaches to the recording or counting of loans involving further advances and/or where more than one loan to a borrower is secured by a single charge.
- thus there may be good reasons why "numbers" in Firm A's section E3-6 do not agree exactly with the "numbers" reported for the same loans in the loan administrator's section G1.1

Q5 Are the "bases" for determining "numbers of loans being administered" in section G1.1 and in section J1.2 column 1 [i.e. Mortgage Administration activity for the FSA fee tariff measure] the same?

This question is about the underlying basis, rather than suggesting that the reported figures would be the same. The figures could not be the same for the simple reason that the number reported in J1.2 column 1 is only half of the number of loans being administered.

The coverage of the FSA fee tariff measure for mortgage administration in section J1.2 column1 is actually quite different from the coverage of loan administration in section G and, moreover, the number of loans in section G is not defined in terms of first charges:

- the fee tariff measure relates to number of mortgage contracts secured by a first charge, whereas section G relates to loans secured by first or second charges
- for the fee tariff measure of "the number of contracts being administered", each first charge counts as one contract, irrespective of the number of loans involved. In section G, where a borrower has several loans secured by a single first charge, it is more likely that each loan will be reported separately in the count for "numbers of loans"
- the fee tariff measure covers residential loans to individuals and corporates, whereas section G only covers residential loans to individuals
- the fee tariff measure covers loans administered by the regulated entity for third parties as well as any loans that the entity has on its own balance sheet, whereas loans in section G relate only to loans administered for third parties.
- the use of the term "mortgage contract" in the fee tariff measure, is not the same as "regulated mortgage contract" and covers loan contracts that are regulated or non regulated
- lastly, the fee tariff number of loans to be reported is not the actual number of loans administered: it is actually 50 % of the numbers administered

Section J: Fee Tariff Measures

Information on the FSA and FOS fee tariff measures is available as follows:

a) "Helptext" forming part of the On-line Regulatory Reporting system

There is some guidance that appears as part of the Help text for section J in the online reporting system. Details have however been added to the Integrated Regulatory Reporting (IRR) pages of the FSA website. A link is attached: (select "Guides and information packs" and look for a note on "MLAR section J Help-text")

http://www.fsa.gov.uk/Pages/Doing/Regulated/Returns/IRR/index.shtml

b) Questions & Answers appearing as part of the FSA Fees website

These were first added to the website in April 2006.

They provide QAs on each of the FSA and FOS tariff measures.

If, in the light of these new QAs, any firm feels that its fee tariff data already supplied to the FSA needs revising, it should submit revised information.

The link to these QAs is as follows:

http://www.fsa.gov.uk/Pages/Doing/Regulated/Fees/faqs/mlarj.shtml

Note: Any queries on Fee tariffs in Section J should be addressed to:
FSAFees@fsa.gov.uk

[END OF MLAR QUESTIONS AND ANSWERS]

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