Guidance consultation

GC 16/8 - Amendments to Guidance on loan to income ratios in mortgage lending

November 2016

We are asking for your written responses to this Guidance Consultation by the 10th of January 2017. We cannot guarantee that we will consider any responses received after this date.

You can send your response by email to LTIratios@fca.org.uk or by post to:

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Strategy and Competition
The Financial Conduct Authority
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Canary Wharf
London
E14 5HS

Email: LTIratios@fca.org.uk

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

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Abbreviations used in this document

FPC	Financial Policy Committee
LTI	loan to income
PRA	Prudential Regulation Authority

1 Overview

Introduction

1.1 This consultation sets out the FCA's proposed amendments and clarification to the general guidance we issued in October 2014 regarding the Financial Policy Committee's (FPC) Recommendation on loan to income (LTI) ratios in mortgage lending.[1] These amendments are being made to reflect findings that the current fixed quarterly nature of the LTI flow limit could make it harder for some firms to manage their business pipeline. In light of this we are now consulting on a move to a four-quarter rolling limit.

Who does this consultation affect?

1.2 This consultation is relevant to FCA-authorised mortgage lenders that:

- are not a subsidiary of Prudential Regulation Authority (PRA) authorised firms
- write annual residential mortgage lending in excess of £100m, and
- issue more than 300 regulated mortgage contracts over four consecutive quarters

Context

1.3 The FPC is charged with acting to remove or reduce systemic risks to protect and enhance the resilience of the UK financial system. In June 2014, the FPC noted that recovery in the UK housing market has been associated with a marked rise in the share of mortgages extended at high LTI ratios. Increased household indebtedness may be associated with financial and economic instability.

1.4 Acting against excessive debt will make the financial system more stable and will reduce the direct and indirect impacts on the firms that we regulate. This primarily advances our market integrity objective by reducing the chance of an unsustainable credit boom, which in turn leads to a more sound, stable and resilient financial system. It is also compatible with our strategic objective of ensuring that the relevant markets function well.

1.5 In 2014 the FPC made a recommendation on LTI ratios in mortgage lending. The recommendation was addressed to the FCA and the PRA. It asked the regulators to ensure that mortgage lenders limit the number of mortgage loans made at or greater than 4.5 times LTI to no more than 15% of their total number of new mortgage loans. In

[1] FG14/8 *Guidance on the Financial Policy Committee's recommendation on loan to income ratios in mortgage lending* (October 2014)

FG14/8, the FCA issued general guidance on its expectations for FCA-authorised mortgage lenders.

1.6 The FPC has recently finalised its second review of the policy package. The FPC has decided to leave the calibration of both the affordability test and the LTI flow limit unchanged. This decision is explained in the November Financial Stability Report, including an updated assessment of the benefits and costs of the policy package.

Summary of our proposals

1.7 In its consultation on changes to its rules, the PRA explained that the way the FPC's recommendation has been followed shows that the application of the LTI flow limit has not raised significant challenges for firms. However, the current fixed quarterly nature of the LTI flow limit could make it harder for some firms to manage their business pipeline. In light of this and improved data availability, we are now consulting on moving to a four-quarter rolling limit, which is aligned with what the PRA has proposed. The proposed amendments to our general guidance are set out in Annex 1.

1.8 Our consultation also contains additional clarification on:

- the scope of the LTI flow limit regarding second charge mortgages
- interest roll-up bridging loans, and
- mortgages ported to another property where there is no increase in the principal outstanding

Equality and diversity considerations

1.9 Under the Equality Act 2010, we must consider the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we assess the equality and diversity implications of any new policy proposals.

1.10 This amendment to our guidance on the LTI limit is not expected to impact mortgage lending and housing transactions.

1.11 We do not consider that the proposals in this consultation adversely impact any of the groups with protected characteristics, i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

1.12 We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will look at them again when we publish our final guidance.

Next steps

1.13 We want to know what you think of the proposals in this paper. Do you agree with the proposed amendments in our consultation?

1.14 The consultation will close six weeks after publication. Please respond by 10 January 2017. We will consider your feedback and publish finalised guidance.

2 Proposed Changes

The loan to income flow limit

2.1 Our general guidance on the LTI flow limit was first applied on a quarterly basis due to data quality concerns and to aid monitoring the limit. However, the fixed quarterly nature of the LTI flow limit can affect firms' ability to manage their business pipeline. In addition, the seasonal nature of the mortgage market could create difficulties for firms, particularly for smaller lenders. Given improvements in data availability and quality, these concerns have been addressed and we consider it appropriate to monitor the LTI flow limit on a four-quarter rolling basis instead.

2.2 FCA-authorised mortgage lenders are expected to monitor flows of loans at the end of every quarter for a period of four quarters in total. These four quarters refer to the immediate quarter under consideration and the three quarters preceding that (see paragraph 2.5 for a worked examples explaining the proposals).

2.3 We will continue to monitor the limit using Product Sales Data (PSD) and the change would not affect PSD reporting practices.

2.4 We are proposing that the four-quarter rolling limit will apply as soon as possible, with an aim to start in Q1 2017 subject to responses to the CP. This would mean that, from Q1 2017, the FCA would monitor the LTI flow limit on a four-quarter rolling basis incorporating data on flows from Q2 2016, Q3 2016, Q4 2016 and Q1 2017. It is important to note that satisfying the current fixed quarterly limit would automatically mean that a firm’s lending at or above 4.5 times LTI would not exceed the limit under a four-quarter rolling basis.

Worked Examples

Example 1: comparing the current approach (quarterly limit) with the new proposal (four-quarter rolling limit)

2.5 Table 1 illustrates how the calculation relevant to the LTI flow limit under the current quarterly limit compares to the calculation under the new proposed changes. The table shows total loan flows by quarter (A to G) and total flows of loans with an LTI ratio of 4.5 or higher (a to g). The table shows that under the proposed changes, the relevant LTI limit calculation takes into consideration flows during the last four quarters, compared to flows during one quarter under the current limit. For example in Q1 2017, the LTI flow limit under a four-quarter rolling limit will be based on flows for Q2, Q3 and Q4 in 2016 and Q1 2017 (i.e. total loans flows A to D and total high LTI loan flows a to d). Under the current quarterly limit only flows in Q1 2017 (d and D) would count.

Table 1: Comparing the current approach with the new proposal

Firm A's loans flows:

Quarters based on PSD reporting	**Q2 2016**	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Q2 2017**	**Q3 2017**	**Q4 2017**
Total loan flows (volume)	A	B	C	D	E	F	G
Total loans with an loan to income ratio >=4.5 (volume)	a	b	c	d	e	f	g

Firm A's calculation and application for the purpose of the LTI flow limit:

Quarters based on PSD reporting:	**Q2 2016**	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Q2 2017**	**Q3 2017**	**Q4 2017**
Current calculation: Percentage of flows with LTI>=4.5 under a ***quarterly limit***	a ÷ A <15%	b ÷ B <15%	c ÷ C <15%	d ÷ D <15%	e ÷ E <15%	f ÷ F <15%	g ÷ G <15%
Calculation under new proposal: Percentage of flows with LTI>=4.5 under ***four-quarter rolling limit***				(a+b+c+d) ÷ (A+B+C+D) <15%	(b+c+d+e) ÷ (B+C+D+E) <15%	(c+d+e+f) ÷ (C+D+E+F) <15%	(d+e+f+g) ÷ (D+E+F+G) <15%

Example 2: numerical example of a case where a firm would be over the LTI flow limit under the current approach, but would be within the LTI flow limit under the new proposal

2.6 The introduction of the four-quarter rolling limit will allow firms to accommodate seasonal fluctuations and peaks in demand for high LTI mortgages. This is illustrated in Table 2. The table shows Firm A's total flows and flows of high LTI loans in the upper section of the table. In this example, Firm A has issued 17.5% of its mortgages to high LTI customers during Q2 of 2017, which could be due to a seasonal peak in demand. Under the current quarterly limit, Firm A would have been over the 15% LTI limit (as can be seen by the number highlighted in red).

2.7 However, under the proposed change to a four-quarter rolling limit, it is the total loan volumes during the four quarters up to and including Q2 2017 (Q3 and Q4 2016 and Q1 and Q2 2017) that are taken into account. Table 2 shows that during those four quarters Firm A issued 67 mortgages with an LTI ratio at or above 4.5. During the same period the total volume of mortgages was 460. This would mean that 14.6% of Firm A's mortgages had an LTI ratio at or above 4.5 and, therefore, the firm would not be over the 15% limit.

Table 2: Example of new proposal

Firm A's loan flows:

Quarters based on PSD reporting	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Total loan flows (volume)	110	120	110	110	120	100	110
Total loans with an loan to income ratio >=4.5 (volume)	10	14	16	16	21	10	9

Firm A's calculation and application for the purpose of the LTI flow limit:

Quarters based on PSD reporting:	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Current calculation: Percentage of flows with LTI>=4.5 under a ***quarterly limit***	**9.1%** (10 ÷ 110)	**11.7%** (14 ÷ 120)	**14.5%** (16 ÷ 110)	**14.5%** (16 ÷ 110)	**17.5%** (21 ÷ 120)	**10.0%** (10 ÷ 100)	**8.2%** (9 ÷ 110)
Calculation under new proposal: Percentage of flows with LTI>=4.5 under ***four-quarter rolling limit***	-	-	-	**12.4%** (10+14 +16+16) ÷ (110+120 +110 +110)	**14.6%** (14+16 +16+21) ÷ (120+110 +110 +120)	**14.3%** (16+16 +21+10) ÷ (110+110 +120 +100)	**12.7%** (16+21 +10+9) ÷ (110+120 +100 +110)

Additional clarifications

2.8 During our review of the LTI flow limit, the PRA and the FCA felt that additional clarification on specific points would be useful.

Second charge mortgages

2.9 The FPC's recommendation and, consequently, the original FCA and PRA LTI policies, excluded second and subsequent charge mortgages from the LTI calculation. This was because they were not regulated mortgage contracts at the time the recommendation was made. However, the UK's implementation of the Mortgage Credit Directive earlier in 2016 means that second and subsequent charge mortgage contracts are now included in the definition of regulated mortgage contracts. Hence, our guidance on the LTI flow limit would automatically apply to lenders' second and subsequent charge mortgage contracts, which are currently exempt from the LTI flow limit.

2.10 In response, we propose to update our LTI general guidance to confirm that second and subsequent charge mortgages remain excluded from the LTI ratio calculation, although we intend to consult on including these loans in the LTI flow limit when loan level data becomes available in the course of 2017. We will continue to work together with the PRA to keep the size of the second and subsequent charge mortgage market under review.

Interest roll-up bridging loans

2.11 Interest roll-up bridging loans allow a borrower to make no interest payments during the life of the loan. For this type of loan, total interest is paid at the end of the maturity of the loan together with the principal repayment. For this reason our conduct rules (MCOB 11) do not require firms to assess a customer's income when underwriting an interest roll-up bridging loan.

2.12 Interest roll-up bridging loans are not currently covered by our guidance on the LTI flow limit, as the LTI ratio is applied 'at the time at which that income is assessed by a firm for the purpose of entering into a regulated mortgage contract with the individual or individuals'. (See definition of 'loan to income ratio' in paragraph 10 of FG14/8, carried forward to paragraph 10 of the guidance we are consulting on now.) This continues to be in line with the FPC's policy intention.

Ported Mortgages

2.13 We noted in in FG14/8 that 'ported' mortgages (i.e. a mortgage taken from one property to another) would count towards the LTI flow limit. At the time, we expected a very small number of mortgages to fall into this category and so the impact on individual firms would be minimal.

2.14 However, to avoid the risk of the LTI limit inadvertently preventing consumers from using any contractual right to port their mortgage, firms may exclude ported mortgages from their calculation of the share of loans with an LTI ratio at or above 4.5 relevant for the application of the LTI flow limit, so long as there is no change to the principal sum outstanding. We are not proposing to amend the guidance, because the exclusion in paragraph 7(1) will apply.

3 Compatibility statement

The compatibility statement

3.1 This section records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including our reasons for concluding that our proposals are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

3.2 Section 1B of FSMA requires us, when discharging our general functions (which include giving general guidance), as far as reasonably possible, to act in a way which is compatible with our strategic objective and advances one or more of our operational objectives. We also need to promote competition, so far as is compatible with acting in a way that advances our consumer protection and/or integrity objectives.

3.3 This section includes our assessment of the equality and diversity implications of these proposals.

3.4 Under the Legislative and Regulatory Reform Act 2006 (LRRA) we are subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions. We must also have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This section sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: compatibility statement

3.5 The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of market integrity. Acting against excessive debt will reduce the chance of an unsustainable credit boom, and will advance our market integrity objective by improving the soundness, stability and resilience of the financial system.

3.6 We consider these proposals to be compatible with our strategic objective of ensuring that the relevant markets function well by improving the soundness, stability and resilience of the financial system. For the purposes of our strategic objective, 'relevant markets' are defined by section 1F of FSMA.

3.7 In preparing the proposals set out in this consultation, we have had regard to the regulatory principles set out in section 3B of FSMA.

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

3.8 Our proposals should not lead to changes in the FCA's supervision approach and is not likely to have a material impact on our use of resources.

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

3.9 We estimate the costs of changing the LTI flow limit from a quarterly limit to a four-quarter rolling limit to be small. Minimal system changes may be needed to monitor and report on a four-quarter rolling limit. However, firms should benefit from the change to a rolling limit, enabling them to smooth seasonal fluctuations in demand and facilitate forward-planning of mortgage pipelines.

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

3.10 Our proposals will help to enhance the resilience of the UK financial system by acting against excessive debt. This should help deliver financial and economic stability in the UK, which enables sustainable growth.

The general principle that consumers should take responsibility for their decisions

3.11 Our proposals do not alter the principle that consumers should take responsibility for their decisions.

The responsibilities of senior management

3.12 Our proposals do not alter the responsibilities of senior management.

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

3.13 Our proposals recognise the differences in the nature and objectives of the businesses the FCA regulates and does not adversely impact a subset of businesses.

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

3.14 Our proposals do not impact on the publication of information.

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

3.15 Following its introduction, the LTI flow limit has been continuously reviewed. We are using this consultation to seek further feedback to our approach and help shape the final guidance to be introduced.

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

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

3.17 In preparing the proposals as set out in this consultation, we have had regard to our duty to promote effective competition in the interests of consumers.

3.18 We believe that, to the extent that smaller firms may be more likely to experience large seasonal fluctuations, the change to a rolling limit may reduce the burden on smaller firms and hence facilitate effective competition in the market.

Equality and diversity

3.19 We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. To address this we conducted an equality impact assessment.

3.20 Our equality impact assessment (EIA) suggests that our proposals do not result in direct discrimination for any of the groups with protected characteristics (i.e. age, disability, gender, pregnancy and maternity, race, religion and belief, sexual orientation and transgender), nor do we believe that our proposals should give rise to indirect discrimination against any of these groups. The outcome of the assessment in this case is stated in paragraph 1.11.

Legislative and Regulatory Reform Act 2006 (LRRA)

3.21 We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance. We have had regard to the LRRA principles and the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance. We consider that our proposals are proportionate and result in an appropriate level of consumer protection and market integrity when balanced with their impact on firms and on competition.

Annex 1

Note to reader: in this Appendix, underlining indicates new text and striking through indicates deleted text.

THE FINANCIAL POLICY COMMITTEE'S RECOMMENDATION ON LOAN TO INCOME RATIOS IN MORTGAGE LENDING:

GENERAL GUIDANCE
<u>(Revised [month] 2016)</u>

A. Application and interpretation

Status of guidance

1. This is general *guidance* given under section 139A(1) of the Financial Services and Markets Act 2000 with respect to the functions of the *FCA*.

2. The implementation of the Financial Policy Committee's (FPC) recommendation on loan to income ratios primarily advances the *FCA's* market integrity objective as it leads to macroeconomic stability by reducing the chance of an unsustainable credit boom, which in turn leads to a more sound, stable and resilient financial system. Doing so is also compatible with the *FCA's* strategic objective by ensuring that the relevant markets function well.

3. This *guidance* sets out the *FCA's* expectations for following the FPC's recommendation.

<u>3A. This *guidance* was initially issued on 1 October 2014 (FG14/8). On [date] the *guidance* was revised.</u>

Application

4. This *guidance* applies to a *firm* with *Part 4A permission* that includes *entering into a regulated mortgage contract* as lender, except if it is:

   (1) a *bank*; or

   (2) a *building society*; or

   (3) a *subsidiary undertaking* of a *bank* or *building society* with *Part 4A permission* that includes *entering into a regulated mortgage contract* as lender; or

   (4) an *insurer*; or

   (5) a *friendly society*; or

(6) a *credit union*.

5. As this *guidance* applies only to a *firm* with *Part 4A permission*, it does not apply to an *incoming EEA firm* (unless it has a *top-up permission* that includes *entering into a regulated mortgage contract* as lender).

6. This *guidance* applies to an *overseas firm* only in relation to activities carried on from an establishment in the *United Kingdom*.

Exclusions

7. The following are excluded from the expectation on high loan to income limit set out in this *guidance*:

(1) *re-mortgages with no change to the principal sum outstanding*; ~~and~~

(2) *lifetime mortgages*<u>; and</u>

<u>(3) *regulated mortgage contracts* that are not a *first charge legal mortgage*.</u>

Interpretation

8. Interpretative provisions (including definitions in the *Glossary*) of the *Handbook* apply to this *guidance* in the same way they apply to the *Handbook*, except where a definition is otherwise provided in paragraph 10 that definition applies for the purpose of this *guidance*.

9. Where an expression in italics is not defined in the *Glossary*, it has the meaning given in paragraph 10.

Glossary of terms defined in this guidance

10. For the purpose of this *guidance*, the following definitions apply:

credit	the cash loan provided by a *firm* under a *regulated mortgage contract*: (a) at the time the *regulated mortgage contract* is entered into; or (b) drawn down at a later date.
high loan to income allowance	the number of *high loan to income mortgage contracts* that a *firm* may enter into in a ~~*quarter*~~ <u>*relevant period*</u> consistent with the expectation in paragraph 14 without any modification under paragraphs 19 to 21.
high loan to income mortgage contract	a *regulated mortgage contract* under which the *credit* provided by a *firm* to an individual, or individuals jointly, is at, or exceeds, the *loan to income ratio*.
income	the gross annual income, before tax and other deductions, of an individual taken into account by a *firm* to calculate the *credit* it will provide under a *regulated*

	mortgage contract.
legal mortgage	includes a legal charge, and in Scotland, a heritable security.
loan to income ratio	a multiple of 4.5 times of an individual's *income* or individuals' joint *income*, at the time at which that *income* is assessed by a *firm* for the purpose of entering into a *regulated mortgage contract* with the individual or individuals.
quarter	any of the four calendar quarters of each calendar year.
<u>*relevant period*</u>	<u>(in relation to a *quarter*) the *quarter* and the three consecutive *quarters* preceding it.</u>
re-mortgage with no change to the principal sum outstanding	a *regulated mortgage contract* in respect of which the following conditions are met:

(a) the amount of *credit* provided under the *regulated mortgage contract* does not exceed that outstanding to:

(i) the *firm*; or

(ii) a different lender,

under a previous *regulated mortgage contract*, or any other type of contract under which the obligation to repay the *credit* provided is secured by a *legal mortgage* on *land*; and

(b) in determining the amount of *credit* provided, no account is taken of:

(i) arrangement fees;

(ii) professional fees and costs; and

(iii) administration costs.

B. Guidance to firms

De minimis conditions

11. Condition A is that in the set of four consecutive *quarters* ending on 30 June 2014, a *firm* has entered into *regulated mortgage contracts* under which the sum of the *credit* provided is, or exceeds, £100 million, but Condition A is not met if the *firm* entered into less than 300 *regulated mortgage contracts* in that period.

12. Condition B is that during both of two consecutive sets of four *quarters*, a *firm* has entered into *regulated mortgage contracts* under which the sum of *credit* provided in

each set of four *quarters* is, or exceeds, £100 million, but Condition B is not met if the *firm* entered into less than 300 *regulated mortgage contracts* in each of those sets of four *quarters*.

13. In this *guidance*, two consecutive sets of four *quarters* is computed as follows:

(1) a new set of four *quarters* starts at the beginning of each new *quarter*;

(2) the four *quarters* in each set run consecutively; and

(3) for the purpose of Condition B:

(a) the first set of four *quarters* ends on 30 June 2014 and the second set of four *quarters* ends on 30 September 2014; and

(b) thereafter:

(i) a first set of four *quarters* ends on 30 September 2014 and on the last day of each subsequent *quarter* that follow; and

(ii) followed by a second set of four *quarters* ending on 31 December 2014 and on the last day of each subsequent *quarter* that follows.

High loan to income limit

14. If either Condition A or Condition B is met in relation to a *firm*, the *FCA* expects <u>that by the end of each *quarter*,</u> the number of *high loan to income mortgage contracts* that the *firm* enters into in ~~a *quarter*~~ <u>the *relevant period* does </u>not ~~to~~ exceed 15% of all *regulated mortgage contracts* it enters into in that ~~*quarter*~~ <u>*relevant period*</u>, unless the *firm* has allocated or received *high loan to income allowance* under paragraphs 19 to 21.

15. Where Condition A is met, the *firm* should carry on its *regulated activity* of *entering into a regulated mortgage contract* in a way that is consistent with the expectation in paragraph 14 from the *quarter* beginning on 1 October 2014.

16. Where Condition B is met, the *firm* should carry on its *regulated activity* of *entering into a regulated mortgage contract* in a way that is consistent with the expectation in paragraph 14 from the start of the second *quarter* following the end of the final *quarter* relevant to the determination that Condition B has been met in relation to the *firm*.

17. Once either Condition A or Condition B is met, the *firm* should carry on its *regulated activity* of *entering into a regulated mortgage contract* in a way consistent with the expectation in paragraph 14 until Condition C is met.

Condition when expectation ceases

18. Condition C is that during both of two consecutive sets of four *quarters*:

(1) the *firm* has entered into *regulated mortgage contracts* under which the sum of *credit* provided is less than £100 million; or

(2) the *firm* has entered into less than 300 *regulated mortgage contracts* in each of those sets of four *quarters*.

Allocation of high loan to income allowance within a group

19. A *firm* that is part of a *group* may allocate all or part of its *high loan to income allowance* to any member of the *group*.

20. If a *firm* has allocated any part of its *high loan to income allowance* to another member of the *group*, the number of *high loan to income mortgage contracts* that it enters into should be reduced by the amount of the *high loan to income allowance* it has allocated.

21. If a *firm* that is part of a *group* has been allocated the *high loan to income allowance* of another member of its *group*, the number of *high loan to income mortgage contracts* entered into by the *firm* should not exceed the expectation in paragraph 14, plus any *high loan to income allowance* allocated to it.

22. The *FCA* expects a *firm* to keep a record of any part of a *high loan to income allowance* it has allocated or received.

Worked examples

23. This paragraph explains by way of a worked example how the de minimis condition applies in the *guidance* ~~by a worked example~~.

For the period 1 July 2013 to 30 June 2014 (Q3 2013 to Q2 2014), Firm X, Firm Y and Firm Z each submit four product sales data (PSD) returns. The cumulative total value of mortgages reported in those four returns for Firm X and Firm Y respectively is less than £100m and for Firm Z it is greater than £100m. On the basis of Condition A, Firm X and Firm Y are each determined to be below the threshold and therefore out of scope of the limit on the date the proposed guidance would apply. Firm Z is determined to be above the threshold and therefore in scope of the limit on the date the proposed guidance would apply. So Firm Z is expected to limit the number of mortgage loans at or above the loan to income (LTI) limit.

We repeat the threshold test when the Q3 2014 PSD returns are submitted. The relevant period is now 1 October 2013 to 30 September 2014 (Q4 2013 to Q3 2014). The cumulative total value of mortgages reported in those four returns for Firm X and Firm Y respectively is equal to or greater than £100m. We notify both firms of this fact but there is no expectation that the firms should limit the number of mortgage loans at or above the LTI limit at this stage. The cumulative total value of mortgages reported in those four returns for Firm Z is equal to or greater than £100m. Firm Z continues to be in scope of the expectations of the guidance and should limit the number of mortgage loans at or above the LTI limit as recommended by the FPC.

We repeat the threshold test when the Q4 2014 PSD returns are submitted. The relevant period is now 1 January 2014 to 31 December 2014 (Q1 2014 to Q4 2014). The cumulative total value of mortgages reported in those four returns for Firm X is equal to or greater than £100m and for Firm Y is less than £100m. On the basis of Condition B, we notify Firm X that it will be within scope of the expectations of the guidance. So Firm X will be expected to adjust its mortgage lending activities to be consistent with the expectations of the guidance and should limit the number of mortgage loans at or above the LTI limit as recommended by the FPC from the next applicable quarter (Q2 2015) beginning on 1 April 2015. However Firm Y remains below the threshold and out of scope of the expectations in the guidance on the LTI limit.

The cumulative total value of mortgages reported in those four returns for Firm Z is equal to or greater than £100m. Firm Z continues to be in scope of the expectations of the guidance and should limit the number of mortgage loans at or above the LTI limit.

23A. The example in Table 1 explains how the four-quarter rolling limit is calculated. The table shows total loan flows by quarter (A-G) and total flows of loans with an LTI ratio of 4.5 or higher (a-g). The table also shows that the relevant LTI limit calculation takes into consideration flows during the last four quarters. For example, in Q1 2017 the LTI flow limit under a four-quarter rolling limit will be based on flows for Q2, Q3 and Q4 in 2016 and Q1 2017 (i.e. total loans flows A-D and total high LTI loan flows a-d).

Table 1: comparing the current approach with the new proposal

Firm A's loans flows:

Quarters based on PSD reporting	**Q2 2016**	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Q2 2017**	**Q3 2017**	**Q4 2017**
Total loan flows (volume)	A	B	C	D	E	F	G
Total loans with an loan to income >=4.5 (volume)	a	b	c	d	e	f	g

Firm A's calculation and application for the purpose of the LTI flow limit:

Quarters based on PSD reporting:	**Q2 2016**	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Q2 2017**	**Q3 2017**	**Q4 2017**
Percentage of flows with LTI>=4.5 under ***four-quarter rolling limit***				(a+b+c+d) ÷ (A+B+C+D) <15%	(b+c+d+e) ÷ (B+C+D+E) <15%	(c+d+e+f) ÷ (C+D+E+F) <15%	(d+e+f+g) ÷ (D+E+F+G) <15%

C. Monitoring

24. The *FCA* will use product sales data returns to monitor which *firms* meet the de minimis conditions in paragraphs 11 or 12.

25. When *firms* meet the de minimis conditions in paragraphs 11 or 12, the *FCA* will monitor their *regulated activity* of *entering into a regulated mortgage contract* for consistency with the expectation in paragraph 14, or as may be modified by paragraphs 19 to 21.

26. When a *firm* meets the de minimis conditions in paragraphs 11 or 12 but has not carried on its *regulated activity* of *entering into a regulated mortgage contract* in a way that is consistent with the expectation in paragraph 14, or as may be modified by paragraphs 19 to 21, the *FCA* may consider using its power under section 55L of the *Act* to, on its own initiative, require the *firm* to stop entering into *high loan to income mortgage contracts*.