

Consultation Paper

CP16/16\*\*

# Minor Handbook changes related to mortgage borrowers with a payment shortfall



June 2016



# Contents

<b>Abbreviations used in this paper</b>	3
<b>1</b> Overview	5
<b>2</b> Proposed changes	7
<b>Annexes</b>	
<b>1</b> List of questions	9
<b>2</b> Cost benefit analysis	10
<b>2</b> Compatibility statement	12
<b>Appendix</b>	
<b>1</b> Draft Handbook text	15

We are asking for comments on this Consultation Paper by 10 August 2016.

You can send them to us using the form on our website at:  
[www.the-fca.org.uk/cp16-16-response-form](http://www.the-fca.org.uk/cp16-16-response-form).

**Or in writing to:**

Olibhia McGinley  
Strategy and Competition Division  
Financial Conduct Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

**Telephone:** 020 7066 7762  
**Email:** [cp16-16@fca.org.uk](mailto:cp16-16@fca.org.uk)

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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 paper

<b>CP</b>	Consultation Paper
<b>CBA</b>	Cost benefit analysis
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>MCOB</b>	Mortgages and Home Finance: Conduct of Business Sourcebook
<b>PS</b>	Policy Statement
<b>CMI</b>	Contractual Monthly Instalment

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# 1. Overview

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## Introduction

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- 1.1 Our Mortgages and Home Finance: Conduct of Business (MCOB) rules set out the requirements for firms when dealing with customers who are experiencing a payment shortfall.
- 1.2 The Financial Conduct Authority (FCA) has recently identified divergent practices among firms in dealing with these customers. To address this variation and to clarify our rules, this consultation paper (CP) proposes two minor changes to our Handbook.

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## Who does this consultation affect?

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- 1.3 This CP will be of interest to any firm currently administering mortgages and trade bodies for these firms. We would also expect interest from those who supply services to firms.

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## Is this of interest to consumers?

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

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## Context

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- 1.5 The rules set out in MCOB chapter 12 are designed to ensure that firms do not impose unfair or excessive charges. In particular, MCOB 12.4.1BR sets out how we expect firms to allocate payments received from customers who are suffering a payment shortfall. The rule aims to ensure that payments are allocated in a way that minimises the time taken to pay off the arrears and thus reduces the amount paid in related fees and charges.
- 1.6 We have recently reviewed a number of firms' allocation of payments processes. As a result, we believe it would be helpful to amend MCOB 12.4.1BR and the Glossary definition of 'payment shortfall' to clarify our expectations and to help ensure an appropriate level of consumer protection.

### Summary of our proposals

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- 1.7** This CP proposes two changes to our Handbook:
- a.** An amendment to the wording of the rule in MCOB 12.4.1BR on the allocation of payments received from customers with a payment shortfall.
  - b.** An amendment to the Glossary definition of 'payment shortfall'.

### Equality and diversity considerations

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- 1.8** We are required by the Equality Act 2010 to consider whether our proposals could have a potentially discriminatory impact on groups with protected characteristics (age, sex, disability, race or ethnicity, marriage and civil partnership, pregnancy and maternity, religion, sexual orientation and gender reassignment). We are also required to have due regard to the need to eliminate discrimination and advance equality of opportunity when carrying out our activities.
- 1.9** We have considered the equality and diversity issues that may arise from the proposals and do not consider that these proposals raise any concerns. We do not consider that these proposals adversely impact any of the groups with the protected characteristics.
- 1.10** We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when we publish the final rules. In the interim, we welcome any input to this consultation on such matters.

### Next steps

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#### What do you need to do next?

- 1.11** We want to know what you think of the proposals in this paper. The consultation will close two months after publication of this paper. Please respond to our questions by 10 August 2016.

#### How?

- 1.12** Use the online response form on our website or write to us at the address on page 2.

#### What will we do?

- 1.13** We will consider your feedback and publish our rules in a Policy Statement (PS).

## 2. Proposed changes

- 2.1** This chapter sets out details of our proposed amendments to MCOB 12.4.1BR and the Glossary definition of 'payment shortfall'. The proposed Handbook amendments are set out in Appendix 1.

### Allocation of payments

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- 2.2** In CP10/2<sup>1</sup>, we consulted on proposals to require firms to allocate a customer's payments to paying off arrears before charges. This requirement was designed to help consumers to exit arrears more quickly by prioritising payments from the borrower to the payment shortfall, rather than to arrears-related charges and the interest. By leaving arrears earlier, the borrower would save on related charges and lessen the probability of default and the related negative impacts.
- 2.3** Following further consultation<sup>2</sup>, we introduced MCOB 12.4.1BR, which states:
- 'When a customer has a *payment shortfall* in respect of a *regulated mortgage contract*, a *firm* must ensure that any payments received from the *customer* are allocated first towards paying off the balance of the *payment shortfall* (excluding any interest or charges on that balance).'
- 2.4** We have recently identified divergent practices among firms when allocating payments received from customers who are suffering a payment shortfall.
- 2.5** We therefore propose to clarify that, when a customer is suffering a payment shortfall, the firm must ensure that no part of any payment received from the customer is allocated towards paying un-capitalised interest or charges incurred because of a payment shortfall before the balance of the payment shortfall has been cleared. MCOB 12.4.1BR does not specify whether the current month's contractual monthly instalment (CMI) should be paid before or after the payment shortfall balance. Where interest and charges have previously been capitalised, these now form part of the capital balance and are paid as part of the CMI. We propose to add a guidance provision to make this clear.
- 2.6** The proposed amended wording of MCOB 12.4.1BR is:

'When a customer has a *payment shortfall* in respect of a *regulated mortgage contract*, a *firm* must ensure that no part of any payments ~~payment~~ received from the *customer* are in respect of that contract is allocated first towards paying off the ~~interest or charges incurred because of a *payment shortfall*~~ before the balance of the *payment shortfall* (excluding any interest or charges on that balance) has been cleared

<sup>1</sup> CP10/2 Mortgage Market Review: Arrears and Approved Persons

<sup>2</sup> CP11/31 Mortgage Market Review: Proposed package of reforms

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

**Payment shortfall**

- 2.7** In CP10/16<sup>3</sup>, we consulted on proposed changes to arrears charging rules and the introduction of a Glossary definition of a payment shortfall.
- 2.8** Following consultation, PS12/16 introduced the following Glossary definition of payment shortfall:
- ‘The outstanding amount to be paid measured against the amount of payments which have become due during the term of a regulated mortgage contract or home purchase plan, including any arrears amount due.’
- 2.9** It was our intention that a payment shortfall, as defined, would not include outstanding amounts other than missed CMI of capital or interest (or both)<sup>4</sup>. We understand that, generally, this is the industry’s interpretation and practice.
- 2.10** However, we believe that it would be helpful for us to amend the definition to make it clear that interest (on missed payments), fees and charges, and ancillary items (such as unpaid service charges settled on behalf of a consumer) do not form part of a payment shortfall. In addition, if a payment shortfall has been capitalised (which may only be done in accordance with our rules), it no longer counts as a payment shortfall. We propose a guidance provision which makes this clear.
- 2.11** We propose to amend the definition as follows:
- a.** ‘The total sum of periodic instalments of capital or interest (or both) that has become due under the terms of a *regulated mortgage contract* but which, in breach of those terms, remains unpaid.
  - b.** The total sum of periodic payments towards the purchase price or of rent (or both) that have become due under the terms of a *home purchase plan* but which, in breach of those terms, remains unpaid.’

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

<sup>3</sup> CP10/16 Mortgage Market Review: Responsible Lending

<sup>4</sup> The definition also applies to Home Purchase Plans where the payments reflect the instalments of the purchase price (rather than capital) and rent (rather than capital and interest).

# Annex 1

## List of questions

- Q1:** Do you agree with our proposal to clarify MCOB 12.4.1BR and provide related Guidance?
- Q2:** Do you agree with our proposal to clarify the Glossary definition of 'payment shortfall' and provide related Guidance?
- Q3:** Do you have any comments on the CBA?
- Q4:** If firms believe they will incur costs as a consequence of what we believe is a clarificatory change, where will these costs be incurred?

## Annex 2

# Cost benefit analysis

1. Section 138I of the Financial Services and Markets Act 2000 (FSMA) requires us to publish a cost benefit analysis (CBA) unless, in accordance with section 138L, we believe that there will be no increase in costs or that the increase will be of minimal significance. Section 138I also requires us to publish an estimate of costs and benefits unless these cannot be reasonably estimated or it is not reasonably practicable to estimate them.
2. We consider that MCOB 12.4.1BR always required firms to ensure that any payment shortfall balance was cleared before shortfall-related (non-capitalised) interest and charges. As a consequence, we believe that this proposal should not result in an increase in costs for firms that are in compliance with the rule as originally drafted.
3. When we consulted on the introduction of MCOB 12.4.1BR in CP10/2<sup>5</sup>, we acknowledged that our proposal would result in costs for firms who did not already allocate payments as required by the rule. However, we explained that these costs would be outweighed by the benefits to consumers that would result from payments being allocated to the payment shortfall balance without charges being added. We estimated<sup>6</sup> that this would help consumers to leave arrears more quickly by reducing arrears interest and charges, thereby lessening the probability of default.
4. There are no additional benefits to the proposed amendments to MCOB 12.4.1BR, apart from enhanced clarity of the rule.
5. The proposed amendment to the Glossary definition of 'payment shortfall' should reinforce the widespread understanding that for the purposes of FCA rules, only missed repayments of capital or interest (or both) constitute a payment shortfall.
6. The proposed amendment does not, in itself, require a firm to incur costs. However, costs may be incurred if, following the proposed amendment to the definition of the payment shortfall, a firm needs to make changes in order to comply with our Handbook rules that rely on the payment shortfall definition. In order to assess one-off and on-going personnel, system and other costs, we gathered data from a sample of firms via a survey. We received 31 responses, 25 of which included information on costs. Of those, 21 respondents indicated that the change to the definition of 'payment shortfall' would result in no costs, or that any cost would be of minimal significance.
7. Three firms said that they would incur one-off costs ranging from £235,000 to £800,000, with one of these firms estimating annual on-going costs between £16,000 and £24,000. Finally, one firm estimated one-off costs in the region of £5.6million, with on-going costs estimated to be £450,000.
8. We consider that the proposed change to the definition of payment shortfall should not result in additional costs to firms who already comply with MCOB 12.4.1BR. The rule requires firms

<sup>5</sup> CP10/2 Mortgage Market Review: Arrears and Approved Persons

<sup>6</sup> CP10/2 Mortgage Market Review: Arrears and Approved Persons, p.25.

to ensure that payments are not allocated to payment shortfall-related interest and charges before the payment shortfall has been cleared. The change to the Glossary definition makes it clear that, for this purpose, a payment shortfall does not include interest and charges related to a payment shortfall. If a firm has to make changes to ensure that payments are not allocated to such interest and charges ahead of the payment shortfall, then we regard any related costs as relating to compliance with MCOB 12.4.1BR under the current Handbook drafting.

**Q3: Do you have any comments on the CBA?**

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

### **Impact on mutual societies**

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9. Section 138K of FSMA requires us to provide an opinion on whether the impact of the proposed rules on mutual societies is significantly different to the impact on other authorised persons. While our proposed amendments may impact mutual societies involved in mortgage lending, the information we gathered from firms shows that the amendments in the consultation should not have a significantly different impact on authorised persons that are mutual societies in comparison with other authorised persons.

# Annex 3

## Compatibility statement

### Compatibility with the FCA's general duties

1. The policy proposals and draft rules in this CP are intended primarily to advance our operational objective of securing appropriate levels of consumer protection by ensuring that customers who are suffering a payment shortfall are treated fairly.
2. We consider these proposals to be compatible with our competition objective and our strategic objective of ensuring that the relevant markets<sup>7</sup> function well.
3. In preparing the proposals set out in this CP, we have had regard to the regulatory principles set out in s3B of FSMA. We set out below how our proposals demonstrate such regard for each of the regulatory principles.

#### **The need to use our resources in the most efficient and economical way.**

1. Our proposals should lead to efficiencies in the supervision of firms by clarifying our expectations.

#### **The principle that an imposed burden or restriction should be proportionate to the benefits.**

2. The proportionality of our approach is addressed in the CBA in Annex 2.

#### **The desirability of sustainable growth in the economy of the United Kingdom (UK) in the medium or long term.**

3. We do not expect the proposals to have a material impact on growth in the UK.

#### **The general principle that consumers should take responsibility for their decisions.**

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

#### **The responsibilities of the senior management of persons subject to requirements imposed by or under FSMA, including those affecting customers in relation to compliance with those requirements.**

5. We do not anticipate any impact on senior management requirements as a result of our proposals.

#### **The desirability, where appropriate, of the FCA exercising its functions in a way that recognises differences in the nature and objectives of the business it regulates.**

6. Our proposals recognise the differences in the nature and objectives of the business the FCA regulates.

<sup>7</sup> 'Relevant markets' are defined by s1F of FSMA.

**The desirability of publishing information relating to persons.**

7. We have the power to publish information relating to investigations into firms and individuals. However, as set out in the Enforcement Guide<sup>8</sup> (EG), we will not normally make public our investigations, findings or conclusions public, except in exceptional circumstances.

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

8. We are an open and transparent regulator. When we developed our proposals set out in this CP, we engaged with industry regarding the potential cost implications, and this is reflected in our CBA.

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<sup>8</sup> EG 6: [www.handbook.fca.org.uk/handbook/EG/6.pdf](http://www.handbook.fca.org.uk/handbook/EG/6.pdf).



# Appendix 1

## Draft Handbook text

**MORTGAGE PAYMENT SHORTFALLS (CONDUCT OF BUSINESS) INSTRUMENT 2016**

**Powers exercised**

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ('the Act'):
- (1) section 137A (The FCA's general rules);
  - (2) section 137T (General supplementary powers); and
  - (3) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force on [*date*].

**Amendments to the Handbook**

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

**Citation**

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

By order of the Board  
[*date*]

## Annex A

### Amendments to the Glossary of definitions

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

Amend the following definition as shown.

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

## Annex B

### Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

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

## 2            **Conduct of business standards: general**

...

Insert the following new section in MCOB 2 after MCOB 2.1. All the text is new and is not underlined.

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

- 2.1A.1    G    A *payment shortfall* is defined in the *Glossary* as the total sum of missed periodic payments of capital or interest (or both) that have become due under the terms of a *regulated mortgage contract* but which, in breach of those terms, remains unpaid. The effect of this is that for a *regulated mortgage contract*, a *payment shortfall* excludes any amounts that are not immediately due and payable under the mortgage contract. In particular, a *payment shortfall* does not include amounts that have been rescheduled for payment over the remaining term of the mortgage (i.e. capitalised, which may only be done in a way that is consistent with the *FCA’s rules*, including those in *MCOB 13*).

...

Amend the following as shown.

## 12           **Charges**

...

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

...

- 12.4.1B R When a *customer* has a *payment shortfall* in respect of a *regulated mortgage contract*, a *firm* must ensure that no part of any ~~payments~~ payment received from the ~~customer~~ are in respect of that contract is allocated first towards paying off the interest or charges incurred because of a *payment shortfall* before the balance of the *payment shortfall* (~~excluding any interest or charges on that balance~~ has been cleared.
- 12.4.1C G In *MCOB 12.4.1BR*, the phrase “interest or charges incurred because of the *payment shortfall*” refers only to amounts that are currently due and payable. This does not include amounts that have been capitalised. So if a *firm* exercises a power under the terms of a mortgage contract to recalculate contractual monthly instalments using a mortgage balance that includes charges (such as *arrears* management charges) or interest arising because one or more monthly instalments were missed, the *firm* does not have to keep a record of the amount of each contractual monthly instalment omitting any element of such charges or interest in order to comply with *MCOB 12.4.1BR*. However, a *firm* may recalculate the contractual monthly instalment in this way only where, and in a way that is, consistent with the *firm*’s obligations under the *Handbook*.

Financial Conduct Authority



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