

BSA Response to FCA consultation paper 16/16

Minor handbook changes related to
mortgage borrowers with a payment
shortfall

Restricted
August 2016

 **Building Societies**
Association

Introduction

1. The Building Societies Association (BSA) represents all 44 UK building societies. Building societies have total assets of over £345 billion and, together with their subsidiaries, hold residential mortgages of over £270 billion, 21% of the total outstanding in the UK. They hold over £250 billion of retail deposits, accounting for 18% of all such deposits in the UK. Building societies account for about 31% of all cash ISA balances. They employ approximately 40,000 full and part-time staff and operate through approximately 1,550 branches.
2. This response has been prepared by the BSA in consultation with its members.
3. We are grateful to the FCA for the open approach it has adopted and willingness to engage throughout the duration of this consultation.
4. The BSA and its members fully support the FCA's intention to ensure borrowers in arrears are treated fairly. Lenders carry out robust affordability checks and stress testing to ensure a loan is affordable for the term of the mortgage. However, unforeseen circumstances can mean a borrower gets into payment difficulties and fails to maintain their contracted monthly payments. When this happens it is in the best interests of both the borrower and the lender to ensure a borrower exits arrears as soon as possible.
5. Lenders will endeavour to work with borrowers and where appropriate offer forbearance measures that will assist the borrower to get back on track with their payments. We agree with the FCA that it is standard practice for firms to allocate payments received from a borrower towards any payment shortfall balance before fees and charges arising from the payment shortfall. We are fully supportive of the FCA's aim to clarify that payments received from a borrower should always be prioritised in this way.
6. We strongly believe that both the FCA and industry are working to achieve the same outcome from this consultation, particularly given that the FCA's stated intention is to provide clarity for industry on existing practice.
7. However, whilst we appreciate that the FCA's intention is to clarify its expectations, we are concerned that the proposals in their current format will unintentionally cause confusion and make what should be straight forward minor amendments to MCOB a far more complex change than we believe was the FCA's intention.

Recommendations

Payment Shortfall Definition

8. It is reassuring that the consultation paper acknowledges in 2.9 that the FCA's intention in amending the definition of payment shortfall is to clarify a point that is "generally the industry's existing interpretation and practice".
9. We broadly agree with the proposed amendment to the Glossary definition of payment shortfall, however believe that further clarity would be achieved by removing the wording "**of capital and interest (or both)**" from the definition to read as follows;

Payment shortfall (a)

the total sum of periodic instalments that have become due under the terms of a regulated mortgage contract but which, in breach of those terms remain unpaid.

10. Removing reference to capital and interest from the definition avoids complicating the issue as the contractual monthly instalment can, over the term of the mortgage be constituted from many different elements, such as for example outstanding interest or fees and charges.
11. The rule as currently written serves to complicate the issue as lenders would have to establish industry wide consensus as to exactly what the contractual monthly instalment (CMI) is made up and at what point these different constituent parts technically form part of the CMI, this detracts from the focus and intended outcome of the proposals which is to clarify that a payment shortfall is made up solely of missed contractual monthly instalments and should be paid before anything else.
12. We believe that our proposed version will achieve the clarity that the FCA is seeking to provide for industry without creating unnecessary confusion. This in turn will remove the need for lengthy guidance as the definition is clear and stands alone.

12.4.1BR

13. Although we appreciate that the rule change 12.4.1BR regarding the allocation of payments was intended to clarify the FCA's expectations and align with existing industry practice, we are concerned that the rule change as proposed will unintentionally cause confusion and make what should be a straight forward minor amendment to MCOB a far more complex change than we believe was the FCA's intention.
14. The intention of the rule is to ensure that any payments received from a borrower are allocated to repay any missed contractual monthly instalments (or the next contractual monthly instalment as the effect is the same) before anything else.
15. If the payment shortfall definition is adopted as proposed, providing a clear unambiguous definition, it is unnecessary to then specifically refer to "not allocating towards interest or charges incurred because of payment shortfall" in 12.4.1BR as this serves to again complicate the issue.
16. It is also inflexible, as whilst we are confident that the industry manages shortfall balances in a manner which meets the FCA's expectations, firms employ a variety of approaches to doing so. Often these differences are driven by system practicalities. For example, some firms hold the various arrears elements in notional account balances rather than separately on their systems. While the application of payments always ensures that the shortfall balance is reduced as swiftly as possible as the FCA intends, the current proposed wording is not sufficiently flexible to allow firms to continue to use existing processes with confidence. We therefore propose that the wording is amended to remove ambiguity and ensure flexibility is maintained avoiding costly system changes.

17. We therefore propose that the wording be revised as follows;

12.4.1BR

When a customer has a payment shortfall in respect of a regulated mortgage contract, a firm must ensure that any payment received in respect of that contract is allocated solely to reduce the payment shortfall and/or to pay the next current monthly instalment, until the payment shortfall balance has been cleared.

18. This also makes clear that it is permissible to allocate a payment received by the borrower to either the payment shortfall or the next contractual monthly instalment. Given that the borrower will be in the same position regardless of which of these their payment is allocated to first this would seem pragmatic. This also aligns with the FCA's statement in the consultation paper which says that "12.4.BR does not specify whether the current month's contractual monthly instalment should be paid before or after the payment shortfall balance"

Guidance (2.1A1.1G & 12.4.1CG)

19. We appreciate that the guidance is intended to help lenders to interpret the payment shortfall definition and 12.4.1BR, however when tested amongst lenders it was found to be a source of more confusion than it was clarity.
20. We believe that the proposed guidance at **2.1A.1G** in Annex B does little to aid understanding and in the interest of clarity should be removed. The first sentence is repeating the definition and the third sentence is implicit in the definition we propose. There was a divergence of opinion as to the meaning of the phrase "not immediately due and payable under the mortgage contract" which therefore served to provide little or no clarity regarding the FCA's expectations. We therefore recommend that the proposed guidance be deleted in its entirety, and that clarification is restricted to the accompanying Policy Statement.
21. We also recommend that the proposed guidance in **12.4.1CG** is deleted and context is given in the accompanying Policy Statement. BSA members felt that this Guidance raises more questions than it answers, for example, this Guidance also refers to amounts that are currently due and payable, which as stated is ambiguous. There is also confusion between the treatment of arrears with the treatment of interest, fees and charges arising from missed payments, which is unhelpful.

Policy Statement

22. We believe that there is scope for the FCA to provide helpful context in the Policy Statement, which could include a very simple example. We have suggested some points below that we think would aid lenders in their understanding of the proposed MCOB amendments and also included a simple worked through example.

Allocation of Payments

23. Lenders must ensure that any payments received from a customer are allocated to either the payment shortfall or to pay the next contractual monthly instalment (CMI) that is due.
24. For example, if a customer has a payment shortfall of £500 and a CMI of £500, a payment of £500 from the customer can be used either to repay the existing payment shortfall, resulting in a missed CMI to the same value, or to pay the CMI resulting in the payment shortfall remaining unpaid. In either scenario the customer will still have a £500 payment shortfall.
25. Similarly, if the customer were to make a payment of £750, it could be used to clear the payment shortfall of £500 and pay £250 off the CMI that is due, leaving the customer with a payment shortfall of £250. Alternatively, the payment could be allocated to the CMI first, and the extra £250 used to reduce the payment shortfall; also leaving the customer with a payment shortfall of £250.

Calculation of CMI

26. Firms have different approaches to the calculation of a customer's CMI. The differences will be reflected in the terms and conditions of the regulated mortgage contract and the systems that are used to manage accounts.
27. Under certain circumstances lenders will recalculate the CMI (which must always be done in a way consistent with a firm's obligation under the handbook) which could result in outstanding interest and other fees or charges (including those that arise due to a payment shortfall) being included within the CMI – these will then be repaid over the remaining term of the contract. MCOB 12.4.1BR does not prohibit allocating payments by the customer to the CMI, even though it now includes those previously-outstanding interest, fees and charges.
28. Should the customer subsequently miss the full, or partial, CMI payment this would represent a (further) Payment Shortfall. Under the proposed changes to the glossary and rules, this would continue to be an acceptable practice.
29. We are keen to continue working with the FCA to achieve the shared intended outcome of the proposed MCOB amendments and would welcome further discussions with the FCA if helpful.

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The Building Societies Association (BSA) is the voice of the UK's building societies.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the government and parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £330 billion, and account for approximately 20% of both the UK mortgage and savings markets