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The Financial Conduct Authority
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Dear Meg,

Guidance consultation: dealing fairly with interest-only mortgage customers who risk being unable to repay their loan

This is the Financial Services Consumer Panel's response to the Financial Conduct Authority's (FCA) consultation on dealing fairly with interest-only mortgage (IOM) customers who risk being unable to repay their loan.

The Consumer Panel welcomes the recent research into the IOM sector¹ and is fully supportive of the FCA's subsequent pre-emptive action, including the publication of this proposed guidance, to empower consumers to take action to avoid future problems and to ensure firms know what is expected of them in terms of how they treat consumers in difficulty.

As the commissioned report identifies, there will be some consumers with IOMs who are unable to take preventative action and find themselves with a shortfall that they are unable to repay at the end of their loan term. Whilst we recognise that the responsibility for repayment of the loan remains the consumer's, we believe it is vital that those who find themselves in this situation, with limited options available to them, are treated fairly.

As mentioned above, we fully support the FCA's action to tackle this problem and its proactive, forward looking approach. However, we also feel it is important not to overlook the cohort that is currently experiencing this very scenario.

Required change to the handbook definition of arrears

Due to the FCA Handbook's current definition of "arrears" an individual with an IOM that has matured with a shortfall, even though they may never have missed a payment, is not protected by MCOB 13 (arrears and repossessions)², which amplifies Principle 6 of the FCA's Principles for Business. An individual who has missed a payment, on the other

¹ <http://www.fca.org.uk/your-fca/documents/research/interest-only-mortgages-gfk>

² <http://fshandbook.info/FS/html/handbook/MCOB/13>

hand, and is therefore in arrears within the definition of MCOB, would be protected. As such, the individual with the complete payment history could find themselves in a worse position than someone within the period of their loan who is defaulting regularly. This creates a perverse incentive for a person with an IOM with a shortfall that is reaching maturity to start defaulting on their repayments in order to be captured by the provisions within MCOB 13 (arrears and repossessions). This surely can't be in the interest of either party. We have attached a case study to illustrate an actual example of how this is currently happening in practice (see annex A).

We welcome the fact that FCA expects firms to proceed with repossession action as a last resort and only after the customer's circumstances have been assessed and all available options considered. However, this must be applied to all situations including where the end of the loan period has been reached. We would urge the FCA to consider changing the current definition of "arrears" to extend to customers whose IOMs have reached maturity, but continue to have a shortfall.

MCOB 11.8.1E (the Mortgage Prisoner Provision)

Part 2 (Guidance Summary) of the consultation sets out ways that firms can demonstrate they are acting in line with Principle 6. This includes considering MCOB 11.8.1E of the FCA Handbook. Whilst we welcome this in theory, we continue to believe that further clarification of how this provision works in practice is required.

For example, we recently saw the example of the Bank of Ireland raising its Standard Variable Rate for consumers on their base rate tracker deal. This affected approximately 13,000 customers who presumably find themselves in a range of positions based on individual circumstances. Those with good Loan to Value that meet the affordability criteria will be able to change product. However, others, previously on a low rate that may not have felt like mortgage prisoners previously, will find themselves trapped on an expensive contract, and disadvantaged in comparison with the 'non-prisoner' borrowers that are able to move. Does the mortgage prisoner provision apply in this case?

In response to CP11/31, the FSA's substantive MMR consultation, the Panel suggested a specific rule to protect mortgage prisoners from being treated unfairly³. We maintain that this suggestion would be more effective in mitigating the risks that exist in this space.

Yours sincerely

Adam Phillips
Chair
Financial Services Consumer Panel

³ <http://www.fs-cp.org.uk/publications/pdf/mmr-mar12.pdf>

Annex A - Interest-only mortgage case study

A customer of a major UK bank has an interest-only mortgage which is coming to the end of its 20 year term. There is an outstanding capital sum of £35,000. The consumer is 63 years old and has work-related and state pensions. He has been paying his contractual monthly instalments. He is not in a position to repay the capital sum at present, as he has been incurring additional expenditure looking after a relative who is seriously ill.

The lender has undertaken all pre-court procedures, and is about to raise repossession proceedings in court. The customer had a meeting with the lender's credit management service to ask if the term of the mortgage could be temporarily extended to give him time to explore equity release, or failing that, the sale of his house. The lender has outsourced the management of his mortgage to a company which has no decision-making responsibilities as regards varying the terms of the loan.

Eventually the customer's request is considered by his bank and is refused with no explanation, other than it is not possible to extend the term of the mortgage. The customer has lived in his home for 20 years and has over £100,000 of free equity in the property, and is willing to explore all alternatives but needs a little more time to do so. Once taken to court, several thousand pounds of legal expenses and charges will be added to the balance of the customer's capital sum in terms of the mortgage contract.

In terms of the FCA's Mortgage Code of Business Sourcebook (MCOB) if the customer had been in arrears he would have enjoyed the protection of Chapter 13 of MCOB which requires lenders to actively explore all possibilities - including extending the term of the loan, or giving more time to pay - to ensure that repossession and homelessness is a genuine last resort. However, Chapter 13 of MCOB does not apply to this consumer as his capital sum debt does not fall within the definition of 'arrears' for the purpose of Chapter 13.

If the customer's interest-only mortgage had come to an end in 3 to 5 years from now (2016-2018), he would have benefited from the FCA and CML's early intervention strategy, whereby lenders are now proactively contacting their customers in order to ensure they prepare for a repayment plan in advance of their interest-only product coming to an end.

The Financial Services Consumer Panel is concerned that there is a cohort of UK consumers with interest-only mortgages coming to the end of their term over the next 24 months or so, who have considerably less consumer protection from a regulatory perspective than customers in arrears of their mortgage or customers with similar mortgage products coming to the end of their term in the next 3 to 10 years. We believe it would be equitable and fair for the definition of 'arrears' in MCOB 13 to be extended to include such customers, at least on a transitional basis, with a view to avoiding unnecessary consumer detriment.