Guidance for firms supporting their existing mortgage borrowers impacted by the rising cost of living – response from UK Finance

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Sent to: MortgagePolicycorrespondence@fca.org.uk

UK Finance is the collective voice for the banking and finance industry. Representing around 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

We work for and on behalf of our members to promote a safe, transparent and innovative banking and finance industry. We offer research, policy expertise, thought leadership and advocacy in support of our work. We provide a single voice for a diverse and competitive industry. Our operational activity enhances members' own services in situations where collective industry action adds value.

We represent the full range of the industry from the largest lenders to the smallest, high street and challenger banks, building societies as well as non-banks and the regulated third-party administrators who service inactive lenders. Our members include lenders who are fully intermediated and lenders who provide advice directly to customers.

Executive summary

The industry welcomes the Financial Conduct Authority's (FCA) *guidance for firms supporting their existing mortgage borrowers impacted by the rising cost of living* (the Draft Additional Guidance). Clarification of existing guidance and rules is useful given that expectations on forbearance and impairment is contained in various thematic reviews, ad-hoc guidance, and market studies published over many years by the FCA and its predecessor, the Financial Services Authority (FSA).

The current economic environment is not temporary – interest rates are normalising at a new level and lenders will continue to support borrowers. Although mortgage arrears remain low, lenders recognise the key role that they play to support borrowers facing increased costs due to inflation, rising energy bills or higher monthly mortgage payments. Lenders are keen to work with all stakeholders to help educate and provide budgeting tools to borrowers who may not have previously experienced a rising rate environment. The FCA's recently produced information page for those *dealing with the financial impact of rising costs of living* is welcomed and well received by the sector. Money guidance and debt advice are important, as this will help customers to determine the appropriate financial choices they might need to make to adjust to the 'new normal' economic environment.

The industry supports the FCA's position that firms should not take a 'one-size-fits-all' approach for those at risk or unable to make their full mortgage payment – tailored forbearance remains appropriate. It will always be in a borrower's best interests to pay some, or all, of their mortgage if they can, as this will reduce their level of repayments in the long run. The Covid-19 Payment Deferral Scheme was a temporary measure, designed to fill the gap before the government's Job Retention Scheme was implemented. This one-off response was a successful solution for a defined period. Pressures on borrower's budgets due to the rising cost of living do not have a clear end point.

Temporary measures should not simply delay or shift payments to other (priority or non-priority) debts. Varying a mortgage contract to reduce mortgage payments cannot continue indefinitely. Similarly, providing *prospective* forbearance too early bears the risk of over-forbearance and, ultimately, increases the possibility of possession if the mortgage becomes unsustainable.

Credit reporting

Our members agree with the FCA that firms should maintain factual reporting of credit information on borrowers' credit files and should be clear in their communications to customers about how any forms of support will be reflected. In line with well-established processes across the finance industry, forbearance must be recorded on the borrower's credit file. Maintaining accurate information via credit reporting is essential. Without this, there is a risk that individuals could take out further debt that is unaffordable, putting them in a worse position in the long run. Lenders have a statutory obligation for the accurate identification and reporting of loans and advances for Regulatory Capital purposes under the Basel rules for banking supervision, and the International Financial Reporting Standards (IFRS) including for the accounting treatment of impaired assets. The factual reporting of a customer's payment history on their credit file should be consistent with this statutory reporting.

It is also important to be clear about the differences between the circumstances of the pandemic and the current cost of living challenges. As mentioned above, Covid-19 was a sudden emergency, with significant uncertainty around the overall scale of the problem. It resulted in some consumers facing an unexpected impact on their income (e.g., due to contracting the virus and needing to self-isolate). While the pandemic was a global issue, the UK government implemented a standardised, no questions asked support package for all borrowers which provided a consistent approach by lenders to the treatment of payment deferrals for capital and impairment calculations/ financial reporting.

The rising cost of living, however, is the result of macro-economic circumstances, where each customer's position will be unique. In these situations, tailored support is appropriate, whether or not this is driven by 'financial difficulty' and, as stated above, the accuracy of credit reporting is paramount to ensure integrity (for use in future lending decisions) and for reassuring customers that their credit file is a true reflection of what has been agreed with their lender.

Masking of borrowers' forbearance arrangements at credit reference agencies, especially in an environment of normalising interest rates, will create a longer-term systemic problem in firms' abilities to understand a customer's creditworthiness. As credit information is also used for performance monitoring, inaccurate recording of forbearance may have the unintended consequence of diluting lenders' ability to proactively identify and contact those borrowers at risk of financial difficulty. We are of the view that any proposal to consider changes to credit reporting would require full consultation, along with guidance from the Prudential Regulation Authority (PRA) and a robust cost-benefit analysis.

The Draft Additional Guidance – key issues

We recognise that the draft guidance seeks to confirm the existing flexibility within the rules. It is important however that the PRA is sighted on any regulatory outputs that relate to forbearance. This will ensure prudential expectations on the treatment of impairment continue to align with the conduct agenda. Further detail is provided below.

There are two key issues within the Draft Additional Guidance that require amendment/ reconsideration.

Firstly, the FCA has set out its expectations where a borrower may be switching from an expiring fixed rate to a higher incentivised or fixed rate. We do not think that this is an *existing* expectation or requirement (and can find no reference to this in existing rules or previous guidance). It appears to contradict both *PS 12/16: Mortgage Market Review* and prevailing industry practice. As per the 7 December 2022 HM Treasury (HMT) statement, lenders are committed to enabling customers who are up to date with payments to switch to a new mortgage deal without an affordability test. We ask that the FCA maintains this position. Declining borrowers who are up to date with their payments and seeking to switch their mortgage will create a further cohort of mortgage prisoners. Requiring an affordability test in this instance, has the potential for greater harm, as borrowers will not be able to protect themselves from further increases to variable rates.

Secondly, we do not think that it is the FCA's intention to loosen the protections offered to borrowers who qualify for a switch to interest-only for a temporary period (as forbearance). We are concerned that, as currently drafted, the guidance implies that lenders should offer a temporary switch to interest-only on demand. We think that this is beyond the expectations in MCOB and could result in both significant risk to lenders and poor outcomes for borrowers. For the avoidance of doubt, we recommend that the FCA replicates the language used in MCOB 11.6.43R "*temporary concession, by which he accepts payment of interest only"* when referencing this type of forbearance.

Borrowers and external stakeholders need to understand that there are checks and balances required when someone seeks to make changes to their mortgage payment. Following the publication of this Draft Additional Guidance, lenders have reported an increase in borrowers seeking a term extension (as contract variation) or temporary switch to interest-only (as forbearance). These borrowers have referenced this guidance, thinking that they have no need to meet criteria or undergo an affordability assessment at all. References to "generally" and "likely" within this guidance should be reviewed to make clear there may be conditions/tests (e.g., understanding ability to pay or materiality to affordability) that need to be satisfied.

Further Handbook changes

We note that the FCA intends to undertake a further review of the Tailored Support Guidance (TSG) and potential changes to existing Handbook Rules (specifically MCOB). We fully support the intent to consolidate the expectations on forbearance, impairment, and borrowers in financial difficulty into the Handbook. There are a number of areas where members have flagged that changes would further help their customers and/ or their operational processes, including:

- the rules on capitalisation of mortgage arrears
- glossary definitions of forbearance and payment difficulty
- clarification on money guidance/ debt advice expectations and the boundary in Perimeter Guidance Manual (PERG).

We provide suggestions for consideration at the end of this response and look forward to engaging with the FCA further on this work in January 2023.

We request that the FCA sets out an immediate timetable for publication of this review – we note that the next iteration of the Regulatory Initiatives Grid has been delayed to the New Year. This provides an opportunity for the FCA to signal its intentions for this comprehensive review and deprioritise existing initiatives in order to provide the necessary capacity to undertake this review.

Request for information (RFI) on cost of living

The FCA will soon change the frequency of its information request around mortgages/ SMEs in light of the increases in the cost of living from weekly to fortnightly. We understand that the revised question set will be focused on those customers entering financial difficulty and the forbearance options being granted to them.

We question the proportionality of this RFI – the questions as currently written are not sufficiently targeted and the frequency does not lead to meaningful data. Lenders advise that volumes do not materially change on a weekly or fortnightly basis. Data provided at anything less than a monthly cadence may be complicated or show some volatility due to borrowers who ‘self-cure’. For example, those who make payment during the month if their direct debit has been returned unpaid. We request that this exercise is revised and the frequency reduced to monthly.