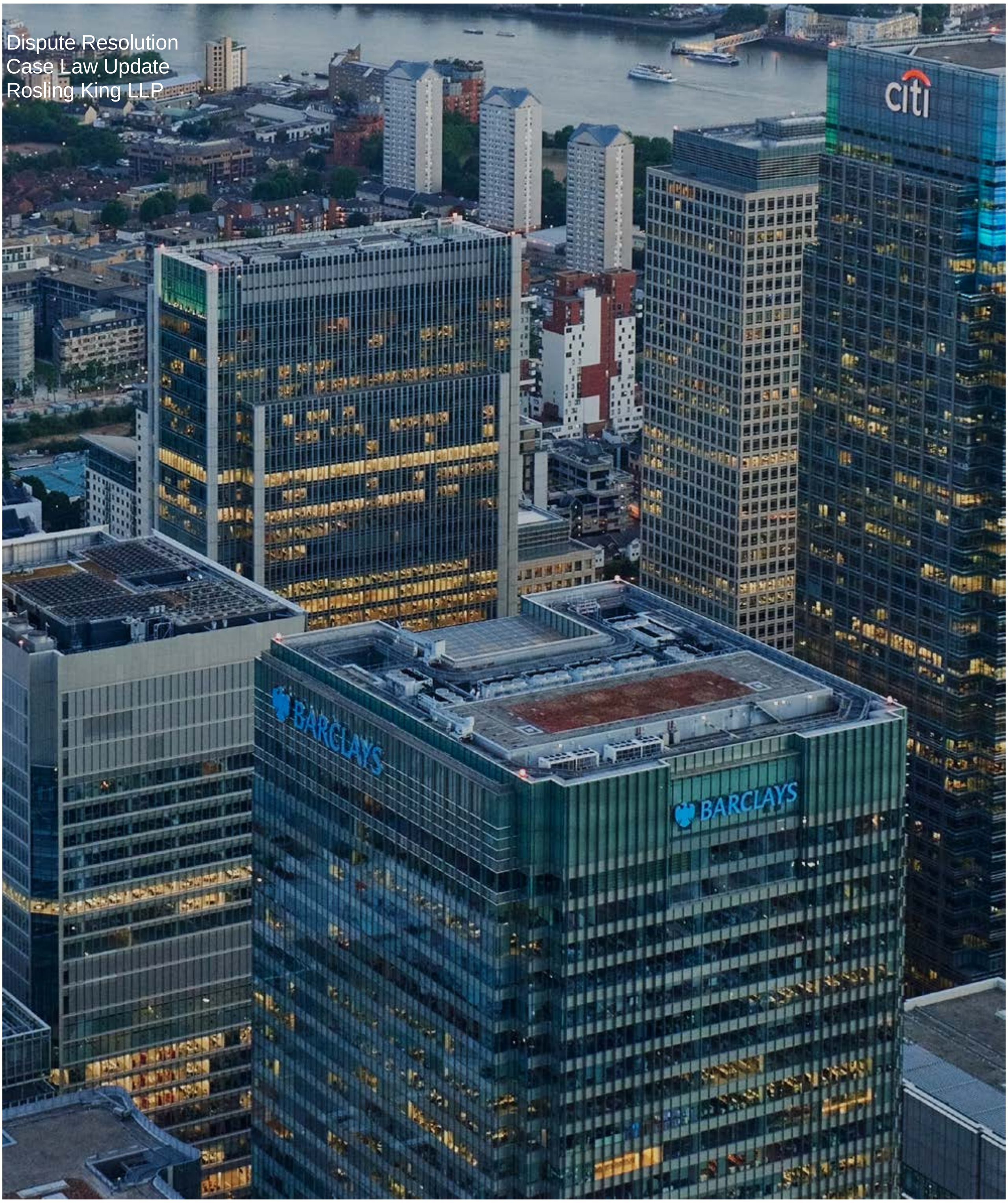
Dispute Resolution
Case Law Update
Rosling King LLP



The Financial Conduct Authority ("FCA") recently issued a guidance consultation (GC16/6) on the fair treatment of mortgage customers in 'payment shortfall', or arrears.

In June 2010, the FCA's predecessor, the Financial Services Authority, introduced a rule in Chapter 13 of the Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB) stating that firms must not automatically capitalise a payment shortfall where the impact on the customer would be material. Capitalisation is only permitted when the individual circumstances of the customer are considered, and with the customer's agreement.

The purpose of this rule is to prevent lenders from applying automatic capitalisations to customer accounts, without first considering their individual circumstances. Historically the practice included: adding the arrears to the mortgage balance owed, extinguishing the arrears, and recovering the arrears through an increase in monthly payments.

The FCA has since identified that some lenders are automatically including customer arrears balances within their monthly mortgage payments, which are recalculated from time to time, for instance, when an interest rate changes. According to the FCA, this procedure falls squarely within the definition of automatic capitalisation and is likely to constitute a breach of its rules, as it lacks transparency and can lead to harm to the customer. By way of example, customers meeting higher mortgage payments and also separately clearing their arrears, are ultimately making overpayments to their mortgage accounts which can result in earlier mortgage repayment. The FCA has therefore written 'John's Story', a case study illustrating how this practice may impact upon customers.

The FCA has not been able to establish precisely how many customers are affected by the issue. However, thanks to its cooperation with an industry working group, representing approximately 66% of the market share based on outstanding mortgage balances, it has managed to estimate that around 750,000 customers could have been affected. This number might now be even higher, due to the Bank of England's recent change to the base rate, which may have led to further recalculation of some customers' mortgage payments.

The FCA has therefore developed a remediation framework in order to provide firms with a proportionate, fair and timely solution. However, it should be noted that that the framework will not be mandatory. The FCA expects each firm to determine its own remediation approach, to achieve fair outcomes for affected customers and the FCA framework is designed to be one of the options available.

Jonathan Davidson, the FCA's Director of Supervision – Retail and Authorisations, said:

"Even if inadvertent, automatic capitalisation of arrears can lead to poor customer outcomes and firms need to put this right, and make sure the practice stops.

Customers do not have to take any action at this stage, as firms will contact them directly. Firms should start identifying affected customers immediately and not wait until the finalised guidance is published.

To prevent similar issues to this one occurring in the future firms need to ensure that all systems are reviewed when considering the implications of a rule change."

Commentary

As a result, firms should start identifying and then contacting directly, affected customers, without waiting for the final guidance to be published. Firms are also welcome to submit their comments on GC16/6 until 18 January 2017.

In the meantime, the FCA intends to monitor the work carried out by firms to determine whether customers have suffered as a result of their approach to remediation. The FCA will reserve the use of formal interventions to deal with any unfair behaviour.

For further information, please contact Georgina Squire or the Partner with whom you usually deal.