

Guidance consultation

GC16/6 - The fair treatment of mortgage customers in payment shortfall: impact of automatic capitalisations

October 2016

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Definitions : these definitions are for use with this guidance consultation only and are not relevant to the FCA Handbook	
<i>When we say</i>	<i>What we mean</i>
Contractual Monthly Instalment (CMI) recalculation	Recalculating the customer's CMI, excluding any payment shortfall balance. <i>This in effect would mean, unless any additional payments are made to reduce the payment shortfall, at the end of the mortgage term, the payment shortfall would remain outstanding.</i>
Reconstituted CMI	The CMI as it would have been if no payment shortfalls had been included in the balances used to automatically calculate CMI during the review period.
Reconstituted payment shortfall balance	The payment shortfall balance as it would have been if payments made by the customer in excess of the reconstituted CMI had been credited against the payment shortfall balance as they were made.
Reconstitution (of a mortgage account)	Restatement of the CMI and payment shortfall balance as they would have been if no payment shortfalls had been included in the balances used to automatically calculate CMI during the review period. The restatement involves calculating a reconstituted CMI and a reconstituted payment shortfall balance.
Additional payments	The amount paid by the customer in excess of the reconstituted CMI.
Mortgage balance	The total amount owed by the customer (including any payment shortfall balances) on their mortgage account or sub-account of their mortgage.

1 Executive summary

- 1.1 We have been considering how firms calculate contractual monthly instalments (CMI) for mortgage customers with payment shortfalls (commonly known as mortgage arrears) and whether this meets our rule requirements and how customers have been affected.
- 1.2 In 2010, our predecessor – the Financial Services Authority – introduced a Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB) rule saying that firms must not automatically capitalise a payment shortfall where the impact on the customer would be material. The purpose of the rule was to stop firms automatically capitalising customers' payment shortfalls without considering their customer's individual circumstances. Our rules were strengthened to prevent customers with payment difficulties not being given a fair opportunity to consider how to repay their arrears.
- 1.3 We have found that some firms have automatically included customers' payment shortfall balances within CMI calculations, following a calculation trigger, such as an interest rate change. The payment shortfalls are treated as still outstanding with firms continuing to pursue the payment shortfall balance separately through their collections processes, treating the balances as immediately due and payable.
- 1.4 We believe that firms' current practice might be driven by their historical calculation systems and Mortgage Terms and Conditions, which aim to ensure the CMI is sufficient to repay the total mortgage balance by the end of term.
- 1.5 We consider that this practice is 'automatic capitalisation'. Even if inadvertent, it results in firms automatically collecting the payment shortfall balance over the remaining term of the mortgage, while also treating them as immediately payable.
- 1.6 The extent of the identified practice varies from firm to firm, with some firms operating systems that automatically capitalise payment shortfall balances for all customers and others for only a small subset of customers.
- 1.7 Automatically including payment shortfall balances within a CMI calculation results in a higher CMI (compared to the payment shortfall balance not being included in the CMI calculation). When the higher CMI is paid this reduces a customer's mortgage balance and the interest charged; effectively customers are making overpayments towards their mortgage balance.
- 1.8 We consider that including payment shortfall balances within CMI calculations may have led, and may continue to lead, to unfair customer outcomes. For example:
 - i. Payment shortfall balances may be overstated if customers meet the new higher CMI (where lenders do not recognise the increased payment as including a partial payment towards the clearance of the payment shortfall balance); this may lead to:

- a) payment shortfalls taking longer to repay, due to the higher CMI reducing customers disposable income
- b) arrears management fees being charged inappropriately when the customer effectively no longer has a payment shortfall
- c) customers' payment shortfall balances being presented unclearly or incorrectly on court applications for possession or suspended possession orders and/or
- d) customers' payment shortfall balances and payment profiles being presented unfairly on credit reference agency (CRA) records

ii. Customers might miss payments on other financial commitments (such as other, more expensive debt) unnecessarily, owing to the higher CMI

- 1.9 Our assessment of this issue has been three-fold. We conducted cross-firm analysis (six firms, representative of the sector); convened an industry working group (ten firms, again representative, and two trade associations); and reviewed a sample of customers' mortgage accounts (55 cases, from two firms).
- 1.10 We identified that all of the firms assessed have updated their collections processes in line with our rule requirements, so their arrears management systems include consideration of customers' individual circumstances before they can arrange a capitalisation of payment shortfalls. However, firms do not appear to have considered the implications for their systems used to calculate customers' CMIs.
- 1.11 We expect firms to put this right, and ensure the practice ceases.
- 1.12 This paper sets out a proposed remediation framework (the framework) for customers who have suffered harm because of automatic capitalisation of payment shortfalls. We have developed the framework with input from the industry working group. It is intended to set out a proportionate, practical and fair approach for remediation. Use of the framework is not mandatory, but we expect firms to determine a remediation approach to achieve fair outcomes for affected customers.
- 1.13 In developing the framework we considered two approaches to correct this issue: putting customers back to the position they should have been in if the payment shortfall automatic capitalisation had not occurred; or putting them back to the position they would have been in if the payment shortfall had not continued to be treated as immediately due after having been capitalised (by extinguishing the payment shortfall balances at the time firms' automatically capitalised them). Our case analysis showed that extinguishing the payment shortfall balance was not appropriate for most customers, because most were unable to meet the higher CMI.
- 1.14 Through our work we also identified that customers' payments shortfalls were driven mainly by events such as ill health and loss of earnings and not by the automatic capitalisation, although this will not have helped customers.

- 1.15 It has not been possible for the FCA to determine the number of customers impacted by this issue across the industry. However, through its work with the industry working group, which represents around 66% of the market share (based on outstanding mortgage balances) it has identified approximately 750,000 impacted customers. This number may be greater now, due to the recent Bank of England base rate change, leading to further recalculation of some customer mortgage payments.
- 1.16 Our analysis indicates that the financial impact for most customers may have been relatively small with estimated remediation likely to be in the low hundreds of pounds. The framework provides firms with an option that they could use to start remediating customers, saving time and cost in coming up with their own approaches. If firms would otherwise conduct individual case reviews we estimate the cost would be on the order of £2,000 per customer. By making the compensation process as efficient as possible much of this cost should be avoidable.

2 Guidance introduction

Who does this consultation affect?

- 2.1 Through this consultation, we are seeking feedback from the industry, consumer representatives, and other interested parties on the proposals set out in [section 3](#) (Guidance for consultation).
- 2.2 This guidance is primarily aimed at residential mortgage lenders and administrators of regulated mortgage contracts.

Is this of interest to consumers?

- 2.3 This guidance consultation may be of interest to mortgage customers and consumer groups representing customers who have experienced, or are experiencing, payment difficulties with their mortgage.

What firms need to do next?

- 2.4 In line with [DISP 1.3.6G](#) and [Principle 6](#), we expect firms to:
 - i. review whether, in respect of regulated mortgages and home purchase plans subject to the relevant FCA rules and Principles during the period since 25 June 2010 ([see below](#)), they have automatically included payment shortfalls balances in their CMI calculations
 - ii. if they have, review whether this practice has caused harm to customers who were protected by the relevant rules and
 - iii. if so, assess and provide appropriate remediation
- 2.5 In addition, we expect firms to:
 - i. explain to affected customers in a way that is clear, fair and not misleading the impact of automatic capitalisation for them and what steps firms are taking to put it right and
 - ii. make whatever changes to policies, procedures and systems are needed to ensure they comply with our requirements, and consider whether terms and conditions are consistent with those requirements
- 2.6 As part of our ongoing regulatory supervision, we will monitor the work firms carry out to determine whether customers have suffered harm as a result, and if so to remediate appropriately. If we find that firms have failed to pay due regard to the interests of their customers and treat them fairly, we will consider appropriate interventions.

Relevant Principles for Businesses and MCOB rules

- 2.7 We consider that the CMI calculation practices identified are likely to breach the Principles for Businesses and MCOB rules. Some of these are set out below.
- 2.8 [MCOB 13.3.4AR](#) – In complying with MCOB 13.3.2AR(6):
- (1) a firm must consider whether, given the individual circumstances of the customer, it is appropriate to do one or more of the following in relation to the regulated mortgage contract or home purchase plan with the agreement of the customer
- (d) treat the payment shortfall as if it was part of the original amount (but a firm must not automatically capitalise a payment shortfall where the impact would be material)¹
- 2.9 [PRIN. 6 Customers' interests](#) – A firm must pay due regard to the interests of its customers and treat them fairly.
- 2.10 [PRIN. 7 Communications with clients](#) – A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
- 2.11 Automatic capitalisations may have been inadvertent, driven by historical systems. Nevertheless, the outcome for customers is the same and it is for firms to put in place fair remediation for customers.

Relevant review period and scope

- 2.12 The review period for remediation begins from 25 June 2010; this is when the relevant MCOB guidance became Handbook rules.
- 2.13 Customers in scope are those with current or past payment shortfalls on a regulated mortgage or home purchase plan to which MCOB 13 applies², where firms have automatically included the payment shortfall balance in calculating the CMI. This includes closed mortgage accounts, and second-charge mortgages where the automatic calculation occurred after 21 March 2016, but will not include buy-to-let mortgages.

Timing of remediation

- 2.14 We propose that firms should notify all customers who are in scope for remediation before 30 June 2017 and remediation programmes concluded within the following 12 months.

¹ the impact of a capitalisation would be material if, either on its own or taken together with previous automatic capitalisations, it increased: 1) the interest payable over the term of the regulated mortgage contract by £50 or more; or 2) the contractual monthly repayment amount under the regulated mortgage contract by £1 or more (see [MCOB 13.3.4AAR](#)).

² To be in scope the mortgage or home purchase plan must have been a regulated mortgage contract at the time when the payment shortfall balance was included in the CMI calculation. By virtue of amendments to articles 60B, 60C and 61 of the Regulated Activities Order which came into force on 21 March 2016, certain regulated credit agreements became regulated mortgage contracts; see [MCOB 1.2.21](#).

3 Guidance for consultation

Remediation framework

- 3.1 This guidance consultation sets out a possible framework (the framework) firms could use when providing remediation to affected customers. We do not propose to require firms to adopt this particular approach. It is for firms to determine their own approach which will ensure fair outcomes for customers.
- 3.2 In this document, remediation refers both to correcting the effects of the automatic capitalisation and, where appropriate, to paying any compensation that is due to the customer.
- 3.3 The framework is set out in [Annex 2](#) and is supported by a 'How to guide' in [Annex 3](#). We summarise it below.
- 3.4 The framework helps firms to identify a range of affected customers through a set of filters. It indicates potential resolutions, and suggests how to calculate appropriate compensation. The outcome for an affected customer could be one of the following:
- i. No action for closed mortgage accounts where the inclusion of a payment shortfall in a single calculation of CMI resulted in an additional payment (see [definitions](#) on page 2) of equal to or less than £10.
 - ii. For open mortgage accounts where the inclusion of any payment shortfalls in a calculation led to an additional payment of equal to or less than £10, a CMI recalculation (see [definitions](#) on page 2), excluding any outstanding payment shortfall balances. This will set a new CMI.
 - iii. For both open and closed mortgage accounts with an additional payment greater than £10, a reconstitution (see [definitions](#) on page 2) of the mortgage account, to put the mortgage account back in the position it would have been in if payment shortfall balances had not been automatically capitalised.
- 3.5 Where firms identify that customers have suffered a loss due to automatic capitalisation the framework sets out one method of compensation. The framework envisages that compensation (if any) will be credited to the mortgage balance or, if the mortgage account is closed, paid to the customers. Customers may receive compensation in the form of:
- i. a refund of incorrectly charged fees and interest, and, where fees have been paid by the customer, interest of 8% a year (simple)

- ii. a payment of interest at 8% a year (simple) for any payments of CMI in excess of the reconstituted CMI which are made after the point at which the reconstituted payment shortfall is cleared
- 3.6 Where the reconstitution of the mortgage account shows that customers cleared their payment shortfalls earlier than previously recorded, firms should correct the customers' credit reference agency records to reflect this.
- 3.7 Following reconstitution for mortgage accounts where the property has been repossessed or there is a possession order (including a suspended possession order) that has not yet been enforced, there are additional steps for firms to take (see paragraphs [3.18 to 3.22](#) for further details). These may result in the firm doing an individual review of the mortgage account to consider whether the customer outcome might have been different if payment shortfalls had not been included in CMI calculations.

Q1: Do you have any comments on the remediation framework and/or 'how to' guide?

Q2: Do you have any comments on the outcomes and/or compensation for affected customers?

Framework limitations

- 3.8 In developing the framework, we have had regard to the regulatory principles in section 3B of FSMA, including the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result.
- 3.9 In [paragraph 1.7](#) we explain that customers who have paid the additional CMI have reduced their mortgage balance and the interest charged. So, through our own work and work with industry we have identified certain filters and thresholds, which aim to ensure that remediation is practical (for firms that use the framework) to deliver, proportionate (to the harm caused by automatic capitalisation) and fair to affected customers. These filters and thresholds mean that there are some limitations to the framework which are highlighted in the sections below ([paragraphs 3.10 to 3.24](#)).

CMI increase threshold

- 3.10 Firms using the framework will only reconstitute mortgage accounts where at least one automatic capitalisation resulted in an additional payment greater than £10 per month. Where there are multiple calculation events the value of the highest single calculation is used. For example, if there have been two calculation events which have resulted in an additional payment of £6 and £8, these mortgage accounts would not meet the CMI increase threshold. Whereas, if after the first calculation the additional payment was £6 and the second £13, the mortgage account should be reconstituted to the point the first additional payment was greater than £10 per month, in this example it would be the second calculation event.

- 3.11 When working with the industry working group we considered a number of thresholds both higher and lower than £10. Analysis showed that at higher thresholds too many customers with significant levels of additional payments would be excluded. At lower thresholds it would have required significant numbers of mortgage accounts to be reconstituted by firms where this would deliver little benefit to the customer. Work conducted by the industry working group and our own analysis indicated £10 to be an appropriate threshold. We are, therefore, suggesting that resolution for customers where any single additional payment is equal to or less than £10 is a recalculation of the CMI, excluding any payment shortfall balance, to correct the mortgage account going forward. The framework does not suggest any compensation for these customers (see [paragraph 3.25](#) for details on customers' rights to complain).

Q3: Do you have any comments on the £10 threshold level?

Method of remediation - reconstitution versus extinguishing arrears

- 3.12 The framework is based on the premise that the harm to customers from automatic capitalisation was caused by the CMI being higher than it would otherwise have been. That is why the proposed remediation approach is based on putting the mortgage account back to where it would have been if the CMI had not been calculated including the payment shortfall balance. Any additional payments made by the customer which have been applied to reduce the customer's mortgage balance should be reallocated (by appropriate accounting adjustments) to the payment shortfall balance.
- 3.13 Another possible approach would be for a firm to reset the payment shortfall balance to zero (extinguishing the payment shortfall) from the point of the CMI calculation (including payment shortfall balances). This is what the firm would do for a formal capitalisation where it had considered the customer's individual circumstances and agreed to treat the payment shortfall as if it was part of the original mortgage balance.
- 3.14 This approach would compensate the customer for the harm caused by firms continuing to treat the shortfall as being due for payment even though repayment had already been spread over the remaining term of the mortgage. This approach might make more sense for a customer who kept up with the higher CMI payments, especially if they also had a separate arrangement to pay the payment shortfall.
- 3.15 With this approach, the mortgage account would not be put back in the position it would have been in if the payment shortfall had not been included in the CMI calculation. Instead, the higher CMI would be left in place, and the payment shortfall would be reset to zero at the point of calculation. Any fees and charges applied as a result of the customer being in payment shortfall after that point would be refunded (unless the customer fell back into payment shortfall), and the customer's credit file would be corrected.
- 3.16 We considered suggesting that firms should look at mortgage accounts both ways to see which produced the best outcome for the customer. We recognise that there will be some customers who would obtain compensation under the 'extinguishing' approach which would not be available under the 'reconstituted' approach. However, our case analysis found that the extinguishing arrears approach would only be appropriate in a relatively small number

of cases, mainly because most customers affected fell back into payment shortfall very quickly (suggesting that they could not afford to keep paying the higher CMI). In addition, firms told us that their systems could not cope with considering remediation in two different ways for every mortgage account.

- 3.17 For these reasons, the framework proposes that the 'reconstitution' approach may be followed in all cases with CMI increases above the £10 threshold.

Q4: Do you have any comments on the exclusion of the 'extinguishing' approach under the framework?

Possessions and possession orders (POs)

- 3.18 The framework suggests that certain possession cases should be considered for remediation by individual case assessment. The intention is to identify cases (if any) where the outcome for the customer might have been different if the mortgage account history had been represented on the reconstituted position.
- 3.19 The framework only suggests possession cases be considered where under the reconstituted view of the mortgage account, the customer would not have triggered the firm's possession processes, based on its arrears management policies applicable at the time. See sections 4a and 5a of the 'How to' guide in [Annex 3](#) for more details.
- 3.20 The consideration of certain possession cases is not intended to question the court's judgment in granting possession, but rather to challenge the firm's decision to take possession action when it did, and whether the information provided to the court during the possession application was fairly presented.
- 3.21 We would not expect many cases where automatic capitalisation made the difference between possession being granted or not. If a firm finds a case where it believes, based on a corrected view of the payment shortfall balance and payment history at the time of the application for possession, that it was not right to bring proceedings at that time, it should consider how this affected the customer and remediate appropriately. [Section 4b / A.16](#) of the 'How to' guide provides examples of factors that might be taken into account as part of this remediation.
- 3.22 Where a PO has been granted but not exercised and the mortgage account meets the criteria in paragraph 3.19 firms should consider:
- i. applying to the court to have the PO set aside, or
 - ii. flagging the case to ensure that if firms apply to enforce a PO the court is made aware of the reconstituted position (CMI, payment shortfall balance, payment profile)

Q5: Do you have any comments on the proposed approach to possession cases and cases where a PO has been awarded but not exercised?

Updates to customers' credit reference agency (CRA) records

- 3.23 The framework proposes a proportionate approach to correcting customer credit records where it is perceived there will be most benefit to customers. We have been informed that the process of correcting customers' credit files in volume is unprecedented and complex. The framework proposes that firms update customers' CRA records, to reflect the revised position, where reconstitution shows the customer has exited payment shortfall sooner than recorded by the lender. It does not propose that firms update customers' CRA records for smaller amendments – for example, an amendment from three months to two months payment shortfall – as we understand this is unlikely to provide much benefit to the customer.

Q6: Do you have any comments on the CRA update proposals?

Consequential loss and distress and inconvenience compensation

- 3.24 The framework does not anticipate that firms will consider compensation for consequential loss and/or distress and inconvenience in every case. An example of consequential loss would be additional interest or charges incurred on other debts, if the customer missed payments on those debts because of having to pay the higher CMI. When conducting our case analysis we were able to review customers' primary bank account statements and saw limited evidence of consequential losses. Such losses will depend on an individual customer's circumstances and would require significant investigation in each case. So we concluded it was unlikely to be proportionate or practical for the framework to include consideration of consequential loss.

Q7: Do you have any comments on the exclusion of consequential loss and distress and inconvenience from the framework?

Customers' rights to complain

- 3.25 Firms' communications should make clear to customers that if they do not feel the firm's remediation offer delivers a fair outcome for them, they are entitled to request an individual mortgage account review and to refer their complaint to the Financial Ombudsman Service if they are not satisfied with the outcome.

Q8: Do you have any comments on customers' rights to complain?

Q9: Do you have any other comments on the overall approach to remediation?

Customer communications and timescales to deliver remediation

- 3.26 Our Principles for Businesses require firms to pay due regard to the information needs of their customers, and communicate information to them in a way which is clear, fair and not misleading ([PRIN. 7 Communications with customers](#)). We suggest firms' remediation communications should clearly describe the impact of automatically capitalising payment shortfall balances, what has happened and steps taken to put it right, including:

- i. noting that the firm has determined that it treated payment shortfalls (for some customers) in a way that the FCA considers to be a breach of its rules
- ii. setting out how this may have adversely affected the customer
- iii. advising the amounts of compensation (and any other remedial actions) and how these have been arrived at and
- iv. informing the customer that they are entitled to reject the firm's offer of remediation and instead make an individual complaint to the firm and, if not satisfied with the outcome, to the Financial Ombudsman Service

3.27 We also suggest that the information firms give customers should set out examples of additional costs that customers may have incurred and need to consider. This is so the customer can understand whether the remediation being offered adequately reflects the harm caused. This may include, but is not limited to:

- i. monthly or ad hoc arrears management or litigation fees
- ii. fees for contacting/writing to the customer
- iii. fees for home visits
- iv. unpaid or returned direct debit or cheque fees and
- v. other possible losses or expenses that may have been incurred by the customer

3.28 The time to identify affected customers and to put appropriate remediation in place may vary from firm to firm, depending on the system they use. To help ensure the fair treatment of customers we propose that firms notify all customers who are in scope for remediation ([see paragraph 2.13](#)) as soon as it is feasible, but no later than 30 June 2017. Firms' remediation plans should be concluded within 12 months of the notification date.

Q10: Do you have any views on the proposed customer communications?

Q11: Do you have any comments or suggestions on the proposal for all customers to be notified by 30 June 2017?

Q12: Do you have any comments or suggestions on the proposal for remediation to have concluded within 12 months of the date affected customers are notified?

Professional indemnity insurance

3.29 We are aware that certain professional indemnity insurance policies prohibit admissions of liability without the written consent of the insurer, and have considered this in developing our proposals. We do not consider that following the proposed guidance would, in itself, constitute an admission of liability by firms, but firms should consult their legal advisers if they are unsure about this.

Cost benefit analysis (CBA)

3.30 In this CBA, we are not comparing the costs and benefits of the guidance versus remediation being carried out. Rather we are assessing the costs and benefits of the guidance compared to firms carrying out remediation, but with no guidance on how to do this.

We expect the guidance to have benefits for customers and firms by:

- i. **Giving better outcomes** for customers: the overall aim of the guidance is to help ensure that affected customers are treated consistently and fairly by their mortgage lenders.
- ii. **Providing regulatory certainty** for firms: the guidance gives firms our views on how customers may have been adversely affected by automatic capitalisation, and a possible approach to remediating those impacts.
- iii. **Limiting the costs of compensation**: the framework gives firms an option they could use to start remediating customers, saving time and cost in coming up with their own approaches. If firms would otherwise conduct an individual case review we estimate the costs would be around £2,000. By making the compensation process as efficient as possible much of this cost should be avoidable.

3.31 We have not estimated the costs and benefits of publishing this guidance, largely because it is not clear the approach firms would take to remediating customers in the absence of the guidance. We have also been told that firms cannot assess the cost of using the framework until the guidance is finalised. Finally, firms who think this approach is not right for them may adopt a different approach to remediation. For example, firms with only a few affected customers or whose mortgage account management processes are not highly automated may find it more cost effective to review each case individually, rather than use the framework. We would expect that a framework, which reflects work carried out by us and the industry working group firms, should if anything save firms some of the costs they would have to incur in developing a bespoke approach.

3.32 Based on our discussions with the industry working group, we believe the approach proposed in this guidance will be proportionate for most, but not all, firms.

Q13: Do you have any comments on the costs to implement the framework?

Q14: Do you have any views on whether the costs to remediate customers, either using the framework or another approach, might be disproportionate to the remediation likely to be delivered?

In addition to any comments for Q13 and Q14 please set out your evidence for these.

Equality Impact Assessment (EIA)

- 3.33 We are required under the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an EIA assessment to ensure that the equality and diversity implications of any new policy or guidance proposals are considered.
- 3.34 We believe the proposals in this guidance consultation do not raise equality or diversity questions. We foresee positive impacts for all protected groups, as firms have a better understanding of the rules and undertake remediation.

Q15: Do you have any comments on any equality and diversity issues you believe may arise from our proposals?

4 How to respond to the consultation

- 4.1 We are asking for written responses to this consultation by close of business on 18 January 2017.
- 4.2 We cannot guarantee that we will consider responses we receive after this date.
- 4.3 You can send your response by email to GC16/6@fca.org.uk or by post to Deborah Mullane, Supervision – Retail and Authorisation Division, The Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS.
- 4.4 There is no need to submit a response by post if you are also emailing it.
- 4.5 We have developed the guidance in this guidance consultation in the context of the existing UK and EU regulatory framework. We will keep the proposals under review to assess whether any amendments will be required due to changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.
- 4.6 When responding, please state whether you are doing so as an individual or on behalf of an organisation. Please include your contact details with your response, in case we need more detail from you on the issues you raise.
- 4.7 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.
- 4.8 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.
- 4.9 All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 0790 or email publications_graphics@fca.org.uk or write to Editorial and Digital Department, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

Annex 1: List of questions

Q1: Do you have any comments on the remediation framework and/or 'how to' guide?

Q2: Do you have any comments on the outcomes and/or compensation for affected customers?

Q3: Do you have any comments on the £10 threshold level?

Q4: Do you have any comments on the exclusion of the 'extinguishing' approach under the framework?

Q5: Do you have any comments on the proposed approach to possession cases and cases where a PO has been awarded but not exercised?

Q6: Do you have any comments on the CRA update proposals?

Q7: Do you have any comments on the exclusion of consequential loss and distress and inconvenience from the framework?

Q8: Do you have any comments on customers' rights to complain?

Q9: Do you have any other comments on the overall approach to remediation?

Q10: Do you have any views on the proposed customer communications?

Q11: Do you have any comments or suggestions on the proposal for all customers to be notified by 30 June 2017?

Q12: Do you have any comments or suggestions on the proposal for remediation to have concluded within 12 months of the date affected customers are notified?



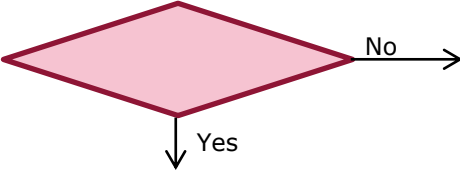

Q13: Do you have any comments on the costs to implement the framework?

Q14: Do you have any views on whether the costs to remediate customers, either using the framework or another approach, might be disproportionate to the remediation likely to be delivered?

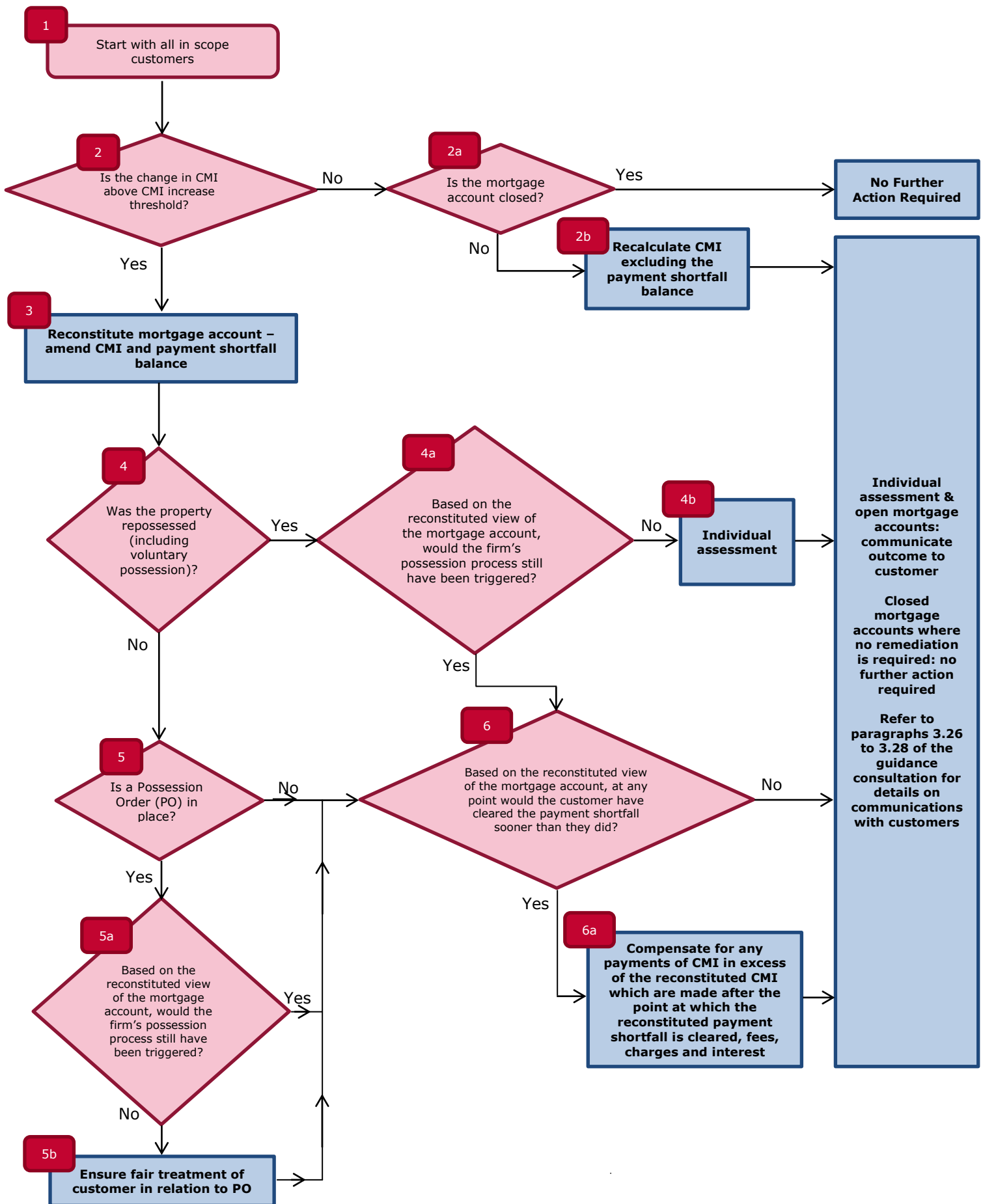
In addition to any comments for Q13 & Q14 please set out your evidence for these.

Q15: Do you have any comments on any equality and diversity issues you believe may arise from our proposals?

Annex 2: Remediation framework

The remediation flow diagram provides a framework for firms to follow	
Key:	
	Start of flow – mortgage accounts enter the flow
	Reference to section in the framework 'how to' guide – provides you with relevant information to help you complete the necessary steps of the process.
	Decision box – answers to questions (yes or no) determine what the next step should be. Depending on your answer to the question you should follow the appropriate arrow.
	Action box – take the relevant action in the blue box before following the arrow to the next step (if applicable)

This flow diagram must be used in conjunction with the remediation framework – How to guide in Annex 3



Annex 3: Remediation framework – 'How to' guide

Introduction

- A.1 The framework is one way firms can provide remediation for customers. This annex provides firms who elect to use the framework with a step-by-step guide to implementing the remediation framework.
- A.2 As firms deliver remediation to customers in scope, they should ensure that they are delivering fair outcomes to their customers.

Step-by step guide through the framework

- A.3 The section numbers correspond to the number shown on the framework flow diagram, [Annex 2](#) of this guidance consultation.

Section 1: Start with all in scope customers

- A.4 Firms should identify all customers that are in scope for remediation. Firms should establish which mortgage accounts have been subject to automatic capitalisation of their payment shortfall since 25 Jun 2010. [Paragraph 2.13](#) in the Guidance Consultation gives more details on in scope customers.

Section 2: Is the change in CMI above CMI increase threshold?

- A.5 If a customer's payment shortfall has been subject to automatic capitalisation since 25 June 2010, this will have resulted in, other things being equal, an increase to the customer's CMI. The framework helps firms identify those customers whose CMI increased by more than £10 per month as a result of automatic capitalisation who are dealt with under [section 3](#).
- A.6 Automatic calculation of the CMI may result in the CMI increasing for other reasons. For example, if the CMI increase was also due in part to an increase in interest rate which accounted for an increase of £20, and the increase attributed to the inclusion of the payment shortfall was £7 (total increase £27), this would not be considered as being above the CMI increase threshold.
- A.7 Where the CMI increase is equal to or less than £10, these customers are dealt with under [section 2a](#).
- **NO – go to section 2a**
 - **YES – go to section 3**

Section 2a: Is the mortgage account closed?

- **YES – no further action is required**
- **NO – go to section 2b**

Section 2b: Recalculate CMI excluding the payment shortfall balance

- A.8 Recalculate the customer's CMI, using a balance excluding any payment shortfall balance outstanding.
- A.9 Any remaining payment shortfall balance can continue to be pursued through the firm's standard collections process.
- A.10 Firms should communicate the outcome to the customer (see Chapter 3, paragraphs [3.26 to 3.28](#) for details on communications).

Section 3: Reconstitute mortgage account – amend CMI and payment shortfall balance

- A.11 The aim of reconstitution is to put the customer's mortgage account back in the position it would have been in had the automatic capitalisation not occurred. Then firms can compare the reconstituted view of the mortgage account with the automatically capitalised view to determine whether the customer has suffered loss as a consequence of the automatic capitalisation, for example, because the customer would have exited payment shortfall more quickly had the automatic capitalisation not taken place.
- A.12 To reconstitute the mortgage account, a firm should restate the CMI and payment shortfall balance as they would have been if no payment shortfalls had been included in the balances used to automatically calculate CMI during the review period. See the [definitions](#) on page 2.

Section 4: Was the property repossessed (including voluntary possession)?

- **NO – go to section 5**
- **YES – go to section 4a**

Section 4a: Based on the reconstituted view of the mortgage account, would the firm's possession process still have been triggered?

- A.13 This question aims to assess whether, based on the reconstituted view of the payment shortfall balance and payment history, the customer would have triggered the firm's possession processes, according to the firm's arrears management policies at the time.
- A.14 For example, the answer to this question would be 'no' if the reconstituted account shows that the customer:
- i. would have been three months in arrears at the point possession proceedings started, and the firm's arrears management policies at that time stated six months in arrears as the trigger for starting the possession process; and/or

- ii. had regularly paid the reconstituted CMI and the firm's arrears management policies at that time stated that the possession process would not be started so long as the customer was meeting the CMI.

- **NO – go to section 4b: individual assessment**
- **YES – go to section 6**

Section 4b: Individual assessment

- A.15 Where firms establish that, on the reconstituted view of the mortgage account, it was not appropriate to start the possession process when they did, they may need to communicate with their customers to determine the impact of the possession action and provide the customer with appropriate compensation. Factors firms should consider in determining appropriate compensation include (but are not limited to): cost of moving; alternate housing costs (e.g. where cost of renting is higher than CMI); cost of missing out on equity appreciation; legal costs; estate agent fees; and any other costs associated with possession and sale.
- A.16 Firms should also compensate the customer for any fees, charges or interest imposed because the customer was in payment shortfall longer than would have been the case had the automatic capitalisation not occurred. Firms should use the process outlined under [section 6a](#).
- A.17 Firms should communicate the outcome to the customer (see Chapter 3, paragraphs [3.26 to 3.28](#) for details on communications).

Section 5: Is a Possession Order (PO) in place?

- **YES – go to section 5a**
- **NO – go to section 6**

Section 5a: Based on the reconstituted view of the mortgage account, would the firm's possession process still have been triggered?

- A.18 The approach to this section is the same as that under [section 4a](#).
- **YES – go to section 6**
 - **NO – go to section 5b**

Section 5b: Ensure fair treatment of customer in relation to PO.

- A.19 Based on a reconstituted view of the mortgage account, where firms establish that they would not have proceeded to obtain a possession order in line with their arrears management policy applicable at that time, firms should consider taking action, which may include:
- i. applying to the court to have the PO set aside, or

- ii. flagging the case to ensure that if firms apply to enforce a suspended possession order the court is made aware of the reconstituted position (CMI, payment shortfall balance, payment profile)

- **Go to section 6**

Section 6: Based on the reconstituted view of the mortgage account, at any point would the customer have cleared the payment shortfall sooner than they did?

- **YES – go to section 6a**
- **NO – Firms should communicate the outcome to the customer** (see Chapter 3, paragraphs [3.26 to 3.28](#) for details on communications).

Section 6a: Compensate for any payments of CMI in excess of the reconstituted CMI which are made after the point at which the reconstituted payment shortfall is cleared, fees, charges and interest

Fees and charges:

- A.20 Firms should refund any fees, charges and interest that were applied to the mortgage account because it was in payment shortfall longer than it would have been without the automatic capitalisation (i.e. those charged after the payment shortfall had been cleared on the reconstituted view of the mortgage account). Where customers paid these fees, firms should also pay interest on this amount at a rate of 8% per year (simple) from the date the fee was paid.
- A.21 Examples of fees and charges which could have been incorrectly applied during the periods highlighted in para A.20 include (but may not be limited to):
- i. monthly or ad hoc arrears management or litigation fees
 - ii. fees for contacting/writing to the customer
 - iii. home visits/third party representative fees
 - iv. unpaid or returned direct debit or cheque fees
 - v. solicitors/legal costs; and court fees

Overpayments:

- A.22 If the customer continued making the higher CMI payments (which included an element attributable to a capitalised payment shortfall) after the payment shortfall balance would have been cleared under the reconstituted view of the mortgage account, this effectively means the customer was making overpayments against the mortgage balance. Interest at 8% (simple) a year should be paid on any payments of CMI in excess of the reconstituted CMI which are made after the point at which the reconstituted payment shortfall is cleared, to compensate the customer for the deprivation of use of these funds.

A.23 Any compensation should be paid for:

- i. open mortgage accounts: by a credit to the amount owed, with appropriate adjustments to the payment shortfall balance (as recorded by firms' collections systems) and
- ii. closed mortgage accounts: by bank transfer or cheque. Firms should take steps to trace these customers

Other actions:

- A.24 In all cases where the customer was in payment shortfall longer as a result of the automatic capitalisation, firms should correct each customer's credit reference agency records, to reflect the date at which the payment shortfall would have been cleared based on the reconstituted payment shortfall balance.
- A.25 Once all adjustments have been applied to the mortgage account, a further CMI calculation should be made. Firms should communicate the outcome to the customer including what the new CMI payment will be going forward (see Chapter 3, paragraphs [3.26 to 3.28](#) for details on communications).