TOPIC 28

Arrears and debt management

LEARNING OBJECTIVES

We have looked so far at the positive side of buying a house and arranging a mortgage – the excitement of buying a property, the technicalities of the buying process and the types of mortgage that can be used. While the majority of property owners manage to meet their mortgage commitments, even if money is tight at times, a small minority of borrowers cannot repay. This topic looks at the options available to lenders and borrowers in this situation.

By the end of this topic, you should have an understanding of the following:

- MCOB rules for the treatment of borrowers with a payment shortfall;
- possible courses of action to help borrowers with a mortgage payment shortfall;
- sources of advice for borrowers;
- government and other schemes to help borrowers with a payment shortfall;
- the principles of using mortgages for debt consolidation.

THINK . . .

In your studies so far we have placed a lot of emphasis on the need to assess affordability. In theory, a careful assessment of affordability should minimise the numbers of people who have difficulty paying their mortgage but changes in personal circumstances cannot always be foreseen.

To focus your thoughts before starting work on this topic, think about the different circumstances that might leave people unable to afford their mortgage repayments. Perhaps this is a situation that has happened to you, or to people you know. If so, what options were available to help you/them resolve the situation?

TOPIC 28

28.1 What are the MCOB rules on borrowers with a payment shortfall?

Before looking at the possible courses of action to help borrowers facing a payment shortfall, we need to understand the regulatory position. The two overarching principles are that a lender:

- must treat those in difficulty fairly; and
- must not take advantage of their vulnerable position.

The detailed rules are set out in MCOB 13.

28.1.1 Dealing fairly with customers

MCOB 13 requires that a borrower who has arrears or a mortgage debt shortfall must be dealt with fairly by the lender. The lender is required to put in place written policy and operational procedures for dealing with such cases, which should include the provisions outlined in Figure 28.1.

FIGURE 28.1 LENDERS' RESPONSIBILITIES IN DEALING WITH CUSTOMERS WITH MORTGAGE DEBT OR ARREARS

Seek agreement

Use reasonable efforts to reach agreement with the borrower over the method of repaying the arrears or shortfall.

Liaise

Liaise with a third-party source of advice regarding the arrears or shortfall.

Allow time

Adopt a reasonable approach to the time over which the arrears or shortfall should be repaid, taking into account the borrower's circumstances.

Permit changes

Allow the borrower to change the mortgage payment date or repayment method, unless the lender has good reason not to do so.

Consider options

Where no reasonable payment arrangement can be made, consider allowing the borrower to remain in the property until a sale is made.

Take possession as a last resort

Take possession of the property only when all other reasonable attempts at resolution have failed.

The Financial Conduct Authority (FCA) considers that a 'reasonable period' for repayment of arrears or a shortfall will depend on the borrower's circumstances. In some cases, it can mean spreading the payments over the remaining mortgage term.

A firm must also establish and implement clear, effective and appropriate policies and procedures to ensure the fair treatment of customers whom the firm understands, or reasonably suspects, to be particularly vulnerable.

IN BRIEF

WHAT MUST THE LENDER DO IF A BORROWER HAS A PAYMENT SHORTFALL?

- Where a borrower has a payment shortfall, the lender must not attempt to process more than two direct debit requests in any one calendar month.
- If the borrower's bank has refused to pay the lender's direct debit at least once in each of two consecutive months due to insufficient funds, the firm must:
  - — consider whether the payment method is still suitable for the borrower;
  - — make reasonable efforts to contact the borrower to discuss whether the payment method is still suitable;
  - — not pass on any costs arising from the failed direct debits.

If a borrower is in arrears, the lender must consider whether one or more of the following actions would be suitable to help resolve the problem:

- extend the mortgage term;
- change the mortgage type;
- defer payment of interest due on the mortgage or sums due under a home purchase plan;
- treat the payment shortfall as if it was part of the original amount – known as 'capitalisation' and effectively adding the shortfall to the capital owing;
- make use of any government forbearance schemes to help borrowers with problems.

Note that the firm must not automatically capitalise a payment shortfall where the impact would be 'material'. MCOB defines capitalisation as 'material' if, on its own or taken together with previous automatic capitalisations, it increases the interest payable over the mortgage term by £50 or more or the contractual monthly repayment amount by £1 or more.

29. CeMAP 2024-25 Topic 28.indd 575 09/05/2024 10:25:29

The firm must give customers sufficient information to help them to understand the implications of any proposed arrangement.

RECORD-KEEPING

The lender must keep records of its dealings with borrowers who are in arrears or have a shortfall debt. The records must be kept for three years from the date of such dealings.

28.1.2 Information provision

Under MCOB 13, the lender must write to the borrower within 15 business days of becoming aware that the account is in arrears. The letter must contain:

1) “the current MoneyHelper information sheet ‘Problems paying your mortgage’;
2) a list of the due payments either missed or only paid in part;
3) the total sum of the payment shortfall;
4) the charges incurred as a result of the payment shortfall;
5) the total outstanding debt, excluding charges that may be made on redemption; and
6) an indication of the nature (and where possible the level) of charges the customer is likely to incur unless the payment shortfall is cleared.”

FCA (2024)

Information included in points 2 to 6 can initially be provided orally but must be provided in a durable medium, together with the MoneyHelper information sheet within the 15-day deadline.

28.1.3 Procedure before taking possession

One action a lender can take if all attempts to rectify the problem have failed is to seek a possession order, to give the lender the right to take possession of the property and sell it to pay off the mortgage. We shall look at that option in more detail in Topic 29, but MCOB 13 requires that, before taking action for possession, the lender must:

- provide a written update of the arrears and charges (see section 28.1.2);
- ensure the borrower is informed of the need to contact the local authority to establish their eligibility for rehousing after the lender takes possession;
- clearly state the repossession procedure.

CONTACTING THE BORROWER

The lender must not put pressure on the borrower through excessive telephone calls or correspondence, or by contact at an unreasonable hour. A reasonable hour is generally considered to be between 8am and 9pm, but must take into account the borrower's known work patterns and religious observance.

28.1.4 Marketing a possessed property

Once a property has been taken into possession, the lender must take steps to:

- market the property for sale as soon as possible;
- take reasonable care to obtain the best price that might be reasonably achieved, taking into account market conditions and the increasing debt. The lender has a duty of care, though it cannot 'nurse' the property, which is the term used when the lender delays accepting reasonable offers in the hope of achieving a 'target' price.

If the proceeds of the sale are less than the debt, the lender must advise the customer as soon as possible after sale of:

- the mortgage shortfall;
- whether another firm – mortgage indemnity insurer, etc – may pursue the debt.

If a lender decides to recover a shortfall, it must notify the borrower of its intention within six years of sale (five years in Scotland). If the proceeds of the sale are more than the debt, the lender must take reasonable steps to inform the borrower and pay the surplus to them, subject to the rights of any subsequent mortgagees.

28.2 What role can the lender play?

The MCOB rules define the minimum requirements for a lender, which leaves the lender with a range of possible courses of action over and above those described in the rules, providing they are fair to the customer.

Lenders should encourage borrowers to contact them as early as possible in cases of difficulty and must do all they can to help borrowers to bring their mortgage accounts to order. The assistance that can be provided can take the form of short-, medium- or long-term measures (see Figure 28.2).

If it appears that the arrears situation can be remedied, the lender has many options. The decision will also be influenced by the lender's perception of the risk posed. For example, if the current LTV is relatively low, the lender's security is under less threat and it might be prepared to consider a wider range of options.

FIGURE 28.2 MEASURES TO DEAL WITH MORTGAGE ARREARS

Short-term measures	Taken prior to litigation, usually when the account is between one and three months in arrears.
Medium-term measures	Introduced once litigation has commenced and may be applicable for cases with up to 12 months' repayment arrears.
Long-term measures	Attempts to restructure or reschedule the loan over a longer term.

28.2.1 Payment of arrears over a given period

The borrower may agree to clear the arrears by paying more than the monthly instalment for an agreed period, known as rescheduling. This may be possible, for example, when a period of unemployment is followed by the borrower taking a job at a salary level that can sustain the increased monthly payments.

Most lenders want to help borrowers but cannot do so indefinitely. It is, therefore, vitally important to:

- permit increased repayments only where they can genuinely be met and there is a real desire on the part of the borrower to address the problem;
- agree the increased payments to bring the account up to date within a reasonable period, based on what the borrower can afford. The FCA requires the situation to be reviewed every three to six months.

The lender can help the borrower to put their mortgage account back into order by working through their household income and outgoings in a thorough and logical way. Many experienced debt counsellors find that borrowers get into financial problems because they are unable or unwilling to take time to plan their budgets and they prioritise payments due to others first. Some lenders have budget factfind aids for use by debt counsellors, while others use outside specialists who are either independent and experienced practitioners or established firms working in this field.

If a plan to pay arrears over a given period is agreed, it should be fully documented for internal records and confirmed to the borrower in writing. If the arrangement is not maintained and court action is required, such documentation will be essential.

28.2.2 Full or partial suspension of monthly payments

Full or partial suspension of monthly payments is used mainly where:

- the mortgage is on a capital repayment basis, although it could be a viable short term measure for interest-only mortgages;
- there is already a reasonable amount of equity (and therefore security) in the property; and
- the lender believes that the borrower's personal and financial circumstances merit it.

It is essentially a short-term measure: the lender grants a payment 'holiday' or partial suspension of monthly payments. Arrears build up over the period of the 'holiday' or suspension, and the borrower must clear them within a set time after the end of the concessionary period.

The lender will need to be confident of the borrower's ability to service not only the normal monthly payments but also the future additional payments necessary to clear the backlog. If they have already fallen behind with the standard monthly payment, what changes to their income or spending habits need to be put in place to enable them to manage the additional payments at a later stage? If the reason for their having fallen behind relates to one-off circumstances beyond their control, which are not expected to recur, the lender may be inclined to be sympathetic – and more optimistic for the success of this option.

28.2.3 Accepting interest-only payments

If the loan is a capital and interest mortgage, the lender may be prepared to accept interest-only payments for a specified period. However, one problem with interest-only payments is that, in the early years of a capital and interest mortgage, most of the monthly repayment is made up of interest. The concession of removing the capital element might be worth very little.

A lender will need to weigh the benefits and drawbacks of this course of action: will the borrower gain any real benefit on a monthly basis if the capital element of the loan at this stage is only small? What are the prospects for making up the deferred capital payments at a later stage?

28.2.4 Extending the term

A repayment mortgage account can be put back on course by extending the term on a short-term or long-term basis. In the latter case, a customer with a ten-year mortgage term could extend it to 15 years to reduce the payments. This option is used with great care by lenders. The borrower must be genuinely committed to keeping the account on course, because it cannot be repeated time after time.

The term of an interest-only mortgage can be extended, but it will only result in additional interest over the term, as no capital is repaid. It is only of benefit if the repayment vehicle term can also be extended to reduce the monthly investment costs. With-profits endowment mortgages cannot usually have their term extended because they mature on a particular date. Other repayment vehicles, such as unit-linked endowments and ISAs, are more flexible and more likely to allow the holder to change payments or the term.

28.2.5 Capitalising the arrears

A lender may also agree to capitalise the arrears: a mortgage of £50,000 with £2,000 arrears (balance outstanding £52,000) might have the arrears effectively built into the loan, making it a loan of £52,000 with no arrears. However, they will be paying interest on the capitalised arrears for a long period, potentially the rest of the mortgage term.

Most lenders will regard capitalisation of arrears as a ‘one-off’ remedy, not usually to be repeated.

28.2.6 Surrendering a supporting investment and changing to a repayment mortgage

If the borrower’s arrears are serious, and the mortgage is supported by an endowment policy that has been assigned to the lender, then the lender has the right to surrender and may well do so as a matter of course. If the policy has not been assigned, it cannot be surrendered unless the borrower is in agreement. Also, the assurance policy may have lapsed already if the borrower is in financial difficulties.

It is not good investment practice to surrender an endowment policy very early. Nearly all policies are geared to long-term capital growth and perform badly over short periods. Early surrender is a way of obtaining capital in a hurry – but in such cases, financial advice should always be sought.

A disadvantage of surrendering the policy is that the loan is converted to a capital repayment mortgage. Payments will increase and alternative life cover should be arranged because the life cover provided by the endowment will end.

Some life assurance companies prefer to allow borrowing against the surrender value of the policy rather than see the policy surrendered. Another option can be to sell the endowment policy in the secondary market. This option is limited to with-profits policies but is usually a better option financially than surrendering the policy. A number of specialist intermediaries can arrange the sale of second-hand endowment policies (or ‘traded endowment policies’). The insurer must inform the policyholder about the availability of the second-hand market when an enquiry is made about surrendering a policy. The borrower should be encouraged to seek financial advice on this issue.

If an interest-only mortgage is supported by an ISA, the borrower has more flexibility, and the borrower could choose to take a lump sum from the ISA without penalty. Bear in mind that the lender has no legal or equitable rights over ISAs, and so cannot force the borrower to use them to pay off the arrears. If the ISA is used in this way, the borrower will need to either increase their future ISA investment to rebuild the capital, or switch to a repayment mortgage.

PENSION FREEDOM

'Pension freedom' now allows personal pension planholders to take as much cash as they want from their pension fund from the age of 55. This can be an attractive option for those in mortgage difficulty, but there are two key factors to consider:

- Only 25 per cent of the fund can be taken tax free, with any excess added to income for the year. This could result in a large (and unexpected) tax liability, which, in turn, could lead to less cash than expected.
- The planholder's income in retirement could be significantly reduced as a result of using the pension fund in this way. In addition, because they cannot take cash from their fund before the age of 55, they will have only limited time to rebuild their pension fund for retirement.

28.2.7 Trading down

If the borrower cannot manage the mortgage payments, another option may be to trade down to a cheaper property, assuming they have reasonable equity in their current property. Trading down will release equity to settle (or reduce) any arrears, and may also provide a deposit for a smaller property. Often, the lender will suspend litigation proceedings if there is a genuine attempt to sell the property with a view to buying a cheaper one.

28.2.8 Other issues

Before any of these options can be considered, the lender must encourage the borrower to take early action to discuss the specific problems relating to the mortgage. A lender might also consider allowing a customer to rent out a room in their home to generate more income, but care must be taken to ensure that a tenancy with rights of occupation is not created.

28.2.9 The Mortgage Charter

In June 2023, approximately 90 per cent of the UK's mortgage lenders, the FCA and the Chancellor of the Exchequer agreed a set of standards to be used when dealing with regulated residential mortgage borrowers who are concerned about the effect of higher interest rates.

The FCA put in effect a number of new MCOB rules from 30 June 2023 to support the Charter and help lenders meet their commitments under the Charter.

The main commitments for lenders are as follows:

- Borrowers concerned about their mortgage repayments can contact their lender for help and guidance without any impact on their credit file.
- Borrowers who are up to date with payments will be given help to switch to a new mortgage deal at the end of their existing fixed-rate deal without another affordability check if they are not increasing their borrowing or changing the type of mortgage.
- Lenders will provide appropriately timed information to help customers plan ahead if their current rate is due to end.
- Borrowers struggling with repayments will be offered tailored support from highly trained staff. This may involve extending the mortgage term to reduce payments, switching to interest-only payments or other solutions depending on the customer's circumstances.

Signatories to the Charter have agreed the following:

- During the first year after the first missed payment, a borrower will not be forced to leave their home without their consent, other than in exceptional circumstances.
- Borrowers nearing the end of a fixed-rate deal will have the chance to lock in a new deal up to six months ahead. They can manage the new deal and request a better like-for-like deal until their new deal term starts, depending on availability.
- Customers who are up to date with their payments can:
  - switch to interest-only payments for six months; or
  - extend the existing mortgage term to reduce their monthly payments, and have the option to revert to the original term within six months.

HM Treasury (2024)

The FCA has amended MCOB 11.6 (Responsible lending) to incorporate the Charter. The changes apply to first-charge residential mortgages and home purchase plans (for term reductions). They do not apply to bridging loans or second-charge mortgages. The two key changes to the rules are as follows:

- Mortgage borrowers can choose to reduce their capital repayments, or to pay interest only, for up to six months.
  - After the agreed period, the borrower will be required to resume full capital repayments, which will include making up for the reduced payments over the remaining term of the mortgage.
  - As long as capital repayments resume within the six-month period, no affordability check is required to support the resumption.
- Those with mortgages or home purchase plans who chose to extend the mortgage/purchase term to reduce payments, can fully or partly reverse the term extension within six months of extending it, without undergoing an affordability check for the revised shorter term.
  - For example, after extending a ten-year term to 15 years, reversing the increase just before the six-month point will result in a revised term of nine years and six months. Although the cost will increase, no affordability check will be required. Reducing the term outside the six-month 'window' will require the lender to carry out a full affordability check.

FCA (2023)

The FCA has stated that the options shown above can be offered on an execution-only basis, rather than on an advised basis. This is subject to the firm providing personalised disclosure outlining the specific changes to the borrower's amounts due and any change to payments, and meeting the Consumer Duty requirement to ensure customers understand the features, costs and benefits of the option they choose.

28.3 Implications of not repaying a mortgage at the end of the term

A mortgage is agreed on the basis that the borrower will repay the debt at, or by the end of, the agreed mortgage term. In the case of a repayment mortgage, as long as the borrower makes the required monthly payments on time, the mortgage will be repaid by the end of the term. With an interest-only mortgage this could be more problematic because an associated investment vehicle may not have produced the expected return, or the borrower may have adopted another repayment strategy that did not provide the expected capital, leaving them with a shortfall.

In the event of the borrower being unable to repay an interest-only mortgage at the end of the term, the lender has the legal right to demand repayment and seek possession. This is a drastic step and, in most cases, the lender will be prepared to discuss alternatives. The introduction of retirement interest-only mortgages (see section 26.10.1) should reduce the number of borrowers in this position. Those with sufficient income and equity will either be able to switch to a retirement interest-only mortgage with their existing lender or, if the lender does not offer such mortgages, they should be able to remortgage with another lender.

If there is a shortfall at the end of the term, there are a number of potential approaches, as outlined below.

28.3.1 Using other capital

If the borrower has savings or access to other capital, such as a pension scheme lump sum, the simplest solution would be to use the other capital to repay the mortgage. This does, of course, depend on what the other capital was intended to be used for and the full implications of diverting it. An example would be the implications of a person a few years from retirement using a pension fund to pay off some or all of a mortgage. While this could be possible, it may leave little time to rebuild the fund for it to provide for a comfortable retirement.

28.3.2 Moving house

On the face of it, selling the property and moving to a cheaper property could be a simple and effective solution, and should result in the shortfall being settled relatively quickly. However, as we saw earlier, there are many reasons why moving or downsizing may not be desirable.

28.3.3 Extending the term

The lender may agree to extend the term of a repayment mortgage with the borrower continuing to make the same monthly payments as before, or perhaps increasing the payment to repay the mortgage as quickly as possible.

In the case of an interest-only mortgage, the lender may agree to extend the term on a repayment basis, with monthly payments calculated to repay the shortfall over an agreed term.

In both cases, it is important for the lender to ensure that the mortgage payments are affordable. If the extended term would take the borrower into retirement, it is important to check that their anticipated retirement income would be enough to support the mortgage.

The introduction of the retirement interest-only mortgage as a separate category of mortgage will present a realistic alternative for those struggling to repay an interest-only mortgage. Although intended to help borrowers in or near retirement, the retirement interest-only mortgage is categorised as an interest-only mortgage rather than a lifetime mortgage, with the addition of the sale of the property on the occurrence of certain specified life events to the list of acceptable repayment strategies.

This type of mortgage will meet the needs of some borrowers who may struggle to find the capital to repay their mortgage but do not want the perceived expense of rolling up interest over the longer term, as happens with a roll-up interest lifetime mortgage. As a retirement interest-only mortgage will be treated as a standard interest-only mortgage, the lender must assess affordability in the usual way, which may prevent some borrowers from taking this option.

28.3.4 Equity release

If the borrower is over 55, equity release may be a solution. Subject to the property value and the age of the borrower(s), it could be possible to clear the deficit through an equity release scheme, either taking the maximum available or through drawdown. Affordability would not be an issue because a standard equity release scheme would not require monthly repayments. However, as we saw in section 26.10, there are pros and cons to equity release, which would need to be considered along with the need to repay the original mortgage.

Hybrid lifetime mortgage schemes are helpful for borrowers who are close to the lender’s minimum age for an interest roll-up scheme, but may wish to take advantage of roll up as they get older. The borrower makes interest-only payments initially but can switch to interest roll-up at any point after a specified age, perhaps 55. As the borrower has the right to switch to interest roll up in the future, the lender is not required to carry out an affordability assessment. Making interest payments obviously means the hybrid mortgage debt will not increase, and so it could buy the borrower time to accumulate money to settle the debt at some point. Alternatively, they could switch to an interest roll-up basis at some future point.

28.4 What state assistance is available to borrowers in arrears?

The government has for some years provided support through SMI for borrowers who have problems paying their mortgage and qualify for certain state benefits. SMI was paid as a benefit to qualifying claimants until 5 April 2018.

SMI then changed to a system where payments are made in the form of a loan that must be repaid. We discussed SMI in depth in section 17.1.4.

CHECK YOUR UNDERSTANDING 1

What is the 52-week linking rule for SMI claims?

28.5 What sources of advice are available?

A range of bodies provide advice to those who run into difficulties with their mortgages. Citizens Advice, for instance, is available in most major towns and cities and can provide guidance to those who need help when they experience difficulties in paying their mortgage. The advice is free and advisers can usually explain the various options available. Citizens Advice is not able to provide financial 'advice', as defined by the FCA in relation to regulated products. It is standard practice for the borrower to be advised to contact the lender as early as possible before the problems escalate. In addition to providing guidance on short-, medium- and long-term arrears problems, Citizens Advice produces information packs on insolvency and bankruptcy.

TABLE 28.1 OTHER SOURCES OF ADVICE*

Name	Description
Money advice centres	Many local authorities provide free debt and benefit advice through money advice centres.
StepChange Debt Charity	A registered charity whose purpose is to assist people in financial difficulty by providing free, independent and realistic advice from trained advisers. The advice is offered through its free telephone advice line and eight centres in the UK.
Financial advisers	Although not free, the services of a good financial adviser can be of great assistance in sorting out debt problems.
Money and Pensions Service	A government-sponsored organisation that offers free and impartial money advice.

*As with Citizens Advice, charities and money advice centres are not authorised to give financial advice as defined by the FCA.

There are several other sources of assistance for borrowers in difficulty. Often, the local office of the Department for Work and Pensions should be the first contact point. Sometimes borrowers are not aware of the benefits they can claim or with whom they should consult.

Some local housing associations are also involved in schemes to assist those in financial difficulties. Several have introduced innovative measures, including schemes offered as mortgage rescue packages.

28.6 How do mortgage rescue schemes work?

Mortgage rescue schemes usually operate in one of two ways:

- An organisation buys the property from the borrower and then rents it back to them, allowing the borrower to remain in their home as a tenant.
- The borrower sells part of the property, leaving them in a shared ownership situation.

Some schemes allow the former owner to repurchase the property if their situation improves.

Schemes are sometimes run by private companies, on a profit-making basis. These schemes are seen as risky because the provider's main motive is profit, which may result in less sympathetic treatment for the borrower. Where the arrangement involves the company buying the property from the borrower and renting it back to them, there have been examples of such schemes increasing tenants' rents to unreasonable levels.

MORTGAGE RESCUE SCHEMES IN SCOTLAND

Mortgage-to-rent scheme

The Scottish Executive introduced the mortgage-to-rent scheme in 2003. Managed by Communities Scotland, the scheme protects homeowners by allowing them to switch tenure from ownership to Scottish secure tenancy. Owner-occupiers in mortgage difficulties can arrange for a social landlord – housing association or local authority, etc – to buy the home and can continue to live there as a tenant.

Mortgage-to-shared-equity scheme

The mortgage-to-shared-equity scheme is for Scottish homeowners who face increasing mortgage and general living costs that affect their ability to pay the mortgage, but who can still make some payment towards the mortgage.

The owner sells up to 30 per cent of the property to the government. The owner can buy the share back at a later date, or share the proceeds with the government when the property is sold. To be eligible for the scheme:

- the property must be the applicant's main home, and they must have at least 20 per cent equity in the property, based on a capital and repayment mortgage;
- the borrower must be at least three months in arrears and have tried, but not succeeded, to reach a repayment arrangement with the lender;

- the borrower cannot have more than £2,000 in savings (£4,000 for those over 60);
- the property must have a minimum value, which will be established by the local authorities, and meet a certain minimum standard of repair (ie be habitable);
- the borrower must seek advice from an independent money advice service and have agreement from the lender to go ahead with the arrangement.

28.7 What are the issues relating to use of a mortgage for debt consolidation?

Mortgages can provide viable options for those who have mounting debt problems. Consolidating debts into a mortgage has advantages, particularly because mortgage interest rates are generally well below those for other types of borrowing.

As we saw in section 8.4.1, borrowers who wish to consolidate debts into a mortgage cannot opt initially to proceed on an execution-only basis. They must be given suitable advice, but they can reject the advice given and then select a product on an execution-only basis.

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CONSOLIDATING MORTGAGE AND DEBT

Ricardo and Tina have a mortgage of £80,000 on their house worth £150,000; the mortgage interest rate is 4.5 per cent and the mortgage has 15 years to run. They have debts of £10,000 on credit cards, with an interest rate of 16.9 per cent. The credit cards are costing them £140 a month in interest (this will reduce each month as some of the capital is repaid) and they have to pay at least £200 a month (2 per cent of the balance); this is affecting their cash flow.

If they add the credit card debt to their mortgage by taking a further advance or remortgage, they will pay £37.50 a month on an interest-only basis, or £76 on a repayment basis, for the additional borrowing over the remainder of their existing mortgage term. This will save them a significant amount each month and ease their cash flow problem.

Consolidating debts in this way can seem an attractive proposition, but there are a number of points to consider.

- The debt being consolidated will now run for the rest of the mortgage term, rather than for around six or seven years, as would be the case if a borrower kept things as they are.
- The extended term is likely to mean paying more interest overall than would be paid by keeping the existing arrangements – a borrower needs to check comparative costs.
- The new mortgage will have to meet the lender's normal affordability and LTV criteria.
- A remortgage is likely to involve costs – potentially up to £500. These will have to be offset against potential savings in order to decide if the consolidation is viable.
- Moving to a new fixed rate or discount rate might save even more money. The borrower will have to assess whether any redemption penalties will impact on the strategy.
- Consolidating the debt will reduce the equity in the property – an important consideration if planning to move in future.
- The borrower might be well advised either to overpay the mortgage to clear the consolidated debt more quickly or to set aside some of the savings with a view to paying off some of the new debt early.
- Securing previously unsecured debts will reduce the equity in the property and increase the risk of repossession if the borrower defaults on the mortgage.
- Having consolidated the debt, a borrower must maintain discipline to avoid putting themselves in the same position a few years later.

If a customer has a mortgage with a drawdown facility, it may be possible to draw down the required funds, although, as a result of the tightening of MCOB rules on assessing affordability, the ability to draw down may be more restricted than before. Alternatively, if the customer has a flexible mortgage, it may be possible to take a payment holiday and accumulate the money in this way, subject to meeting the criteria for such action.

28.7.1 Seeking advice

As we have seen in this topic, consolidating debt into a mortgage can be a viable option for many people. However, borrowers should think carefully before consolidating and, in most cases, should seek advice before making the decision.

In many cases, a borrower will consider consolidation to reduce their monthly outgoings. They may not have too many problems servicing their unsecured debts but may wish to increase their disposable income. In this case, an adviser should point out the potential disadvantages of consolidation and help the borrower to make an informed decision.

In some cases, the borrower may have significant debts that they are struggling to service, and may be considering an individual voluntary arrangement (IVA), whereby some of their debt is written off by their creditors. It is possible for a homeowner to enter into an IVA, but the IVA is likely to contain specific conditions regarding the property, referred to as an ‘equity clause’. This requires the debtor to agree to remortgage their property at a specific point in the IVA, usually during the last year, to make a payment towards their unsettled debt. There are conditions for such an arrangement:

- On the date when the clause is about to take effect, the debtor’s share of the equity in the property must be more than £5,000 (after remortgage costs) at the time of the remortgage, so on a jointly-owned property the equity must be at least £10,000. The clause cannot be activated if the equity share is £5,000 or less. If both owners are subject to the IVA then the clause will treat them as one borrower and the £5,000 equity threshold will apply.
- The required remortgage cannot be for more than 85 per cent of the property value.
- The difference between the original mortgage and the remortgage amount (less remortgaging costs) will be used to pay off some or all of the debt. The amount of equity required to be released will not exceed the unsettled debt.
- The increased mortgage cost must be affordable, cannot exceed 50 per cent of the ‘normal’ IVA payment and any increase in mortgage payments can be deducted from the monthly IVA payment.
- The costs of remortgaging can be deducted from the available amount.
- The remortgage term cannot extend beyond the later of state retirement age or the existing mortgage term.

If the borrower is unable to remortgage as required, the IVA supervisor has the discretion to:

- accept a third-party sum equivalent to what would have been received through a remortgage;
- extend the term of the IVA so that 12 additional monthly contributions are made, with the total amount paid limited to what has been received through a remortgage.

Clearly, the decision whether to enter into an IVA or voluntarily remortgage to clear debts is not simple. Borrowers would be advised to seek professional advice from a debt counsellor, a financial adviser offering debt counselling or charities such as Citizens Advice.

CHECK YOUR UNDERSTANDING 2

Earlier in your studies (Topics 2 and 10) we looked at the rules surrounding the treatment of vulnerable customers. Can you recall:

a) whether a customer seeking a mortgage to consolidate debts can opt for an execution-only sale?

b) the definition of a ‘credit-impaired customer’?

DEBT CONSOLIDATION AND CREDIT-IMPAIRED CUSTOMERS

Where the purpose of the mortgage or further advance is to consolidate debts and the borrower is a ‘credit-impaired’ customer (see section 10.9), the lender must take extra care. If the increased mortgage would not be affordable unless the other debts were paid off, the lender must take ‘reasonable steps’ to ensure that the debts are repaid on completion of the mortgage transaction. Reasonable steps could include the lender paying off the debt on behalf of the customer. Alternatively, the lender can assume the debts would not be paid off and include ongoing payments as committed expenditure in the affordability assessment.

THINK AGAIN . . .

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- summarise the responsibilities of the lender when dealing with customers in arrears?
- state what a lender must *not* do in such situations?
- outline the different options that a lender might consider to help the borrower get their account back in order?
- discuss the purpose of an IVA?
- explain what a borrower might need to consider before deciding to consolidate debt into a mortgage?

Go back over any points you don't understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

References

FCA (2023) *PS23/8 Mortgage Charter: enabling provisions* [pdf]. Available at: www.fca.org.uk/publication/policy/ps23-8.pdf

FCA (2024) *MCOB 13.4 Arrears: provision of information to the customer of a regulated mortgage contract* [pdf]. Available at: www.handbook.fca.org.uk/handbook/MCOB/13/4.pdf

HM Treasury (2024) *Mortgage Charter* [online]. Available at: www.gov.uk/government/publications/mortgage-charter/mortgage-charter

Test your knowledge

?

Use these questions to assess your learning for Topic 28. Review the text if necessary.

Answers can be found at the end of this book.

1) Lenders are under no obligation to contact borrowers about mortgage arrears. True or false?

2) If it becomes clear that a borrower's mortgage account is in arrears, the lender writes a letter to the borrower containing an information sheet by:

   a) StepChange Debt Charity.

   b) MoneyHelper.

   c) Citizens Advice.

3) For how long must a lender keep a record of its dealings with a borrower who is in arrears?

   a) One year from the date of the dealings.

   b) Three years from the date of the dealings.

   c) Five years from the date of the dealings.

   d) Until the end of the mortgage term.

4) Accepting interest-only payments is a way of helping repayment mortgage borrowers facing problems making mortgage payments. True or false?

5) Gavin lost his job a few months ago and is now in arrears with his capital repayment mortgage payments. Although he is trying hard, he sees no prospect of finding a job in the foreseeable future. His lender has turned down his request to capitalise his arrears. Why has the lender turned down his request?

   a) Gavin would not be able to afford the higher payments it would create.

   b) The lender is not legally able to grant such a request.

   c) Gavin's mortgage has not run for long enough for the request to be valid.

6) Extending the term in order to reduce mortgage repayments is not appropriate for low-cost with-profits endowment mortgages. True or false?

7) When George defaulted on the mortgage on his London flat, the lender took possession of his flat and sold it to pay his outstanding mortgage, but the proceeds did not repay the whole debt. Within what period of time must the lender inform George of its intention to pursue him for the remaining shortfall?

   a) One year from the sale.

   b) Three years from the sale.

   c) Five years from the sale.

   d) Six years from the sale.

8) The costs of remortgaging as a result of an IVA can be deducted from the available amount. True or false?

9) In mortgage and debt consolidation, the new mortgage does not have to meet the lender's normal affordability and LTV criteria. True or false?

10) Which of the following statements is true of mortgage rescue schemes?

   a) Schemes never allow the former owner to repurchase the property if their situation improves.

   b) Some schemes allow the former owner to repurchase the property if their situation improves.

   c) All schemes allow the former owner to repurchase the property if their situation improves.