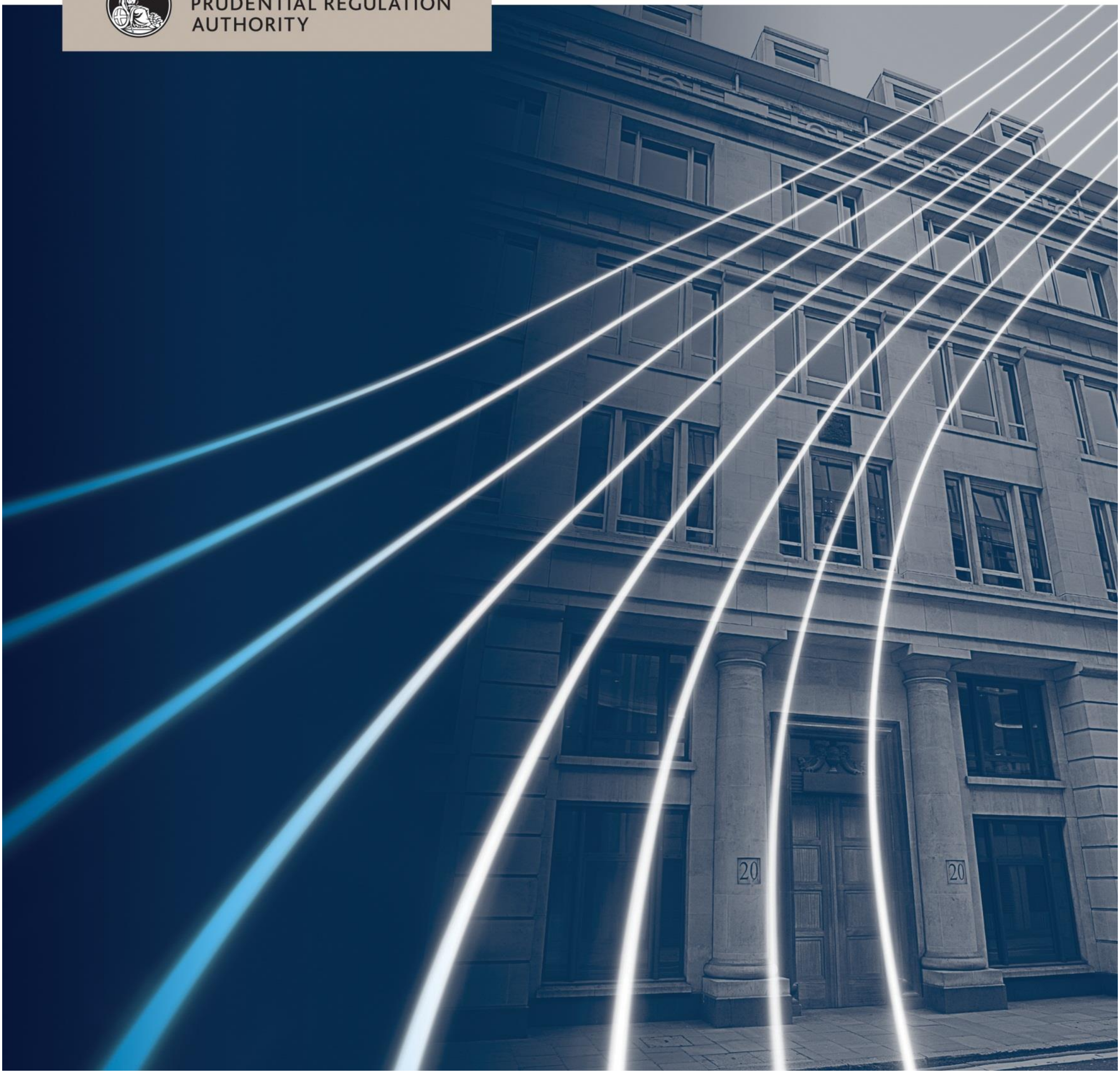
Policy Statement | PS5/17

Amendments to the PRA's rules on loan to income ratios in mortgage lending

February 2017

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Policy Statement | PS5/17

Amendments to the PRA's rules on loan to income ratios in mortgage lending

February 2017

This policy statement contains feedback and final rules following Consultation Paper (CP) 44/16 'Amendments to the PRA's rule on loan to income ratios in mortgage lending'.

1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to responses to CP44/16[1] on amendments to the PRA's rules on loan to income (LTI) ratios in mortgage lending (referred to as 'LTI flow limit' in the remainder of the document) and sets out the final rules for the LTI flow limit to operate on a four-quarter rolling basis.

1.2 This PS is relevant to banks, building societies, friendly societies, industrial and provident societies, credit unions, PRA-designated investment firms, and overseas banks in relation to their UK branch activities and the UK subsidiaries of the above mentioned firms.

1.3 In June 2014 the Financial Policy Committee (FPC) issued a recommendation to the PRA and the Financial Conduct Authority (FCA) advising that they should 'ensure that mortgage lenders do not extend more than 15% of their total number of new residential mortgages at loan to income ratios at or greater than 4.5'.[2]

1.4 In CP44/16 the PRA proposed amending the PRA's rules to change the current fixed quarterly limit into a four-quarter rolling limit. The limit would still need to be complied with and monitored at the end of every quarter, but the relevant flows of loans for compliance with the limit would now be those during a rolling period of four quarters in total, instead of one quarter as currently applied. These four quarters refer to the immediate quarter under consideration and the three quarters preceding it.

1.5 The PRA is now finalising the amendment to the Part proposed in CP44/16. The change is implemented with immediate effect, so that the LTI flow limit is applied on a four-quarter rolling basis from the current quarter onwards. This means that starting from Q1 2017 the PRA would monitor the LTI flow limit on a four-quarter rolling basis, which for Q1 2017 will be incorporating data on flows from Q2 2016, Q3 2016, Q4 2016 and Q1 2017. It is important to note that compliance under a fixed quarterly limit (which was the expectation before this change was introduced) automatically implies compliance with the limit under a four-quarter rolling basis.

1.6 Appendix 1 of this PS contains the final rules.

1.7 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made. No changes to the proposal are included. Chapter 2 sets out feedback to responses received to PRA proposals.

2 Feedback to responses

2.1 The PRA received four responses to CP44/16. All respondents supported the proposal to switch to a four-quarter rolling limit. They agreed that the change is likely to allow firms to manage the limit more effectively, reducing the potential need for sharp changes in lending as a result of the limit.

1 'Amendments to the PRA's rules on loan to income ratios in mortgage lending', November 2016: www.bankofengland.co.uk/pra/Pages/publications/cp/2016/cp4416.aspx.
2 Available at www.bankofengland.co.uk/financialstability/Pages/fpc/prevailing.aspx.

2.2 One of the respondents requested clarification on the definition of income for the purposes of the LTI flow limit. As highlighted in CP11/14[1], 'Implementing the Financial Policy Committee's recommendation on loan to income ratios in mortgage lending' the PRA rules relevant to the LTI flow limit align with guidance on Product Sales Data (PSD) returns. The FCA Handbook[2] provides guidance on 'loan' and 'income' which firms already use when submitting their returns. This guidance stresses that the amount reported should be the income that has been verified in accordance with MCOB 11.6.R.[3] The definition of income in PSD returns provides for some discretion on the part of lenders as to the elements they take into account when calculating a borrower's or borrowers' income. The PRA considers that a firm's definition of income reflects a firm's own internal risk appetite as regards individual lending decisions. Therefore, the PRA does not expect firms to change how they define income as a result of CP44/16 or any rules coming into force without consulting their supervisor.

2.3 Another respondent asked whether the clarification on 'ported mortgages' with no increase in the principal outstanding in CP44/16 requires changes to the reporting of PSD returns. The PRA does not expect firms to revise the way they complete their PSD return following this clarification. The PRA provided details of this in PS9/14.[4]

2.4 The respondent also asked for further clarification on the inclusions and exclusions of 'ported' mortgages. For the purpose of firms' LTI limit calculation the PRA expects firms to exclude those mortgages from existing customers, who are moving property, but where there is no increase in the principal outstanding.

1 June 2014: www.bankofengland.co.uk/pra/Pages/publications/cp/2014/cp1114.aspx.
2 Available at: www.handbook.fca.org.uk/handbook/SUP/16/Annex21.html.
3 Available at: www.handbook.fca.org.uk/handbook/MCOB/11/6.html.
4 'Implementing the Financial Policy Committee's recommendation on loan to income ratios in mortgage lending', October 2014: www.bankofengland.co.uk/pra/Pages/publications/ps/2014/ps914.aspx.

Appendix

---

1 PRA RULEBOOK: CRR FIRMS, NON-CRR FIRMS: HOUSING INSTRUMENT 2017 available at: www.bankofengland.co.uk/pra/Pages/publications/ps/2017/ps517.aspx