EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CLAIMS AND PAYMENTS) AMENDMENT REGULATIONS 2010

2010 No. 796

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

This instrument makes changes to the Social Security (Claims and Payments) Regulations 1987 (S.I. 1987/1968) to make it clear how money which is deducted from a person's benefit and paid direct to a mortgage lender to help with the person's mortgage costs is to be applied. This instrument applies to all benefit customers who have mortgage interest deducted from their benefit (income support, income-based jobseeker's allowance, income-related employment and support allowance, state pension credit) and paid direct to a qualifying lender by the Department for Work and Pensions.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Context

4.1 Claimants in receipt of income support, income-based jobseeker's allowance, an income-related employment and support allowance, or state pension credit may be entitled to help towards their mortgage costs through support for mortgage interest rules. Specifically, this covers eligible interest on loans (up to prescribed capital limits) taken out to purchase a home and on certain home improvement loans.

4.2 There is a maximum capital limit on loans for which interest can be paid. This was increased from £100,000 to £200,000 from 5 January 2009 for claimants making new and some repeat claims to income support, jobseeker's allowance or employment and support allowance. The capital limit of £100,000 still applies to working age claimants who were receiving housing costs before 5 January 2009 and remains unchanged for most people receiving state pension credit.

4.3 Supporting legislation provides that where mortgage interest payments are deducted from benefit and paid directly to a lender under the mortgage interest direct scheme which has been in place since 1992, those payments must be applied towards the discharge of the interest liability.

4.4 Since 1995, the help towards interest on mortgage loans and home improvement loans for homeowners has been calculated by applying a standard interest rate to the capital outstanding on the eligible loan. Using one standard rate on which to base the calculation of interest results in those homeowners with interest rates *below* this rate receiving more support for mortgage interest than is needed to cover their actual interest liability to the lender. That is what the current legislation provides.

4.5 Since December 2004, the standard interest rate – introduced by the Social Security (Housing Costs Amendments) Regulations 2004 (S.I. 2004/2825) – has been based on a formula: the Bank of England base rate plus 1.58%. In the Pre-Budget Report in November 2008, the Chancellor announced that the standard interest rate would be frozen at 6.08% for all claimants receiving help with housing costs, including those claiming state pension credit. The Government has since decided to freeze the rate at 6.08% until June 2010 because allowing it to fall back to 2.08% (as would otherwise have occurred if the Government had not frozen the rates) would have increased the possibility of claimants falling into arrears on their mortgage accounts which could increase the likelihood of having their homes repossessed.

4.6 When use of a standard interest rate was proposed in February 1995, the Government, in its memorandum to the Social Security Advisory Committee, made clear its position on how any excess housing costs payment should be treated. The Government said that it proposed the standard rate on the "principle" that "lenders agree that any payments in excess, resulting from the actual rate being lower than the standard rate, should only be used to credit the claimant's loan account." This central principle reflects the Government's overarching policy that support for mortgage interest payments should be used only to reduce mortgage liabilities for individuals. This is intended to help minimise repossessions as well as safeguard public finances. Future costs to taxpayers might arise where repossessions lead to some former owner occupiers moving into rented accommodation and claiming housing benefit. The latest available estimate of the average cost to the Exchequer of each repossession (not the annual cost) is at least £6,000, based on the current cost of housing benefit for people in the social rented sector. It was never intended that any excess support for mortgage interest be made available to claimants to use for purposes unrelated to meeting their housing costs. However, this principle was not set out in the legislation introducing the standard interest rate, thus creating a loophole.

4.7 The Government's decision to freeze the standard rate at 6.08% to provide additional help in the economic downturn, taken together with the historically low base rates, has significantly increased the number of people who receive more money than is needed to cover their actual mortgage interest liability (see 7.7). The future of the standard interest rate is currently under review, as announced in last year's Pre-Budget Report when the Chancellor

said “once the freeze ends, the Government intends to move towards a fairer, more affordable approach, that more closely reflects mortgage interest rates.”

4.8 These amending regulations clarify how qualifying lenders should apply excess mortgage payments to customers’ mortgage accounts. They provide that any excess should first be applied to any arrears of mortgage interest, and thereafter, towards the discharge of any liability to repay the principal sum or any other liability to the qualifying lender in respect of that mortgage.

4.9 The regulations also make provision for application of the excess in cases where the customer is liable to pay mortgage interest to the same qualifying lender in respect of more than one loan. In such cases the excess will first be applied to any arrears of mortgage interest on the loan to which the payment relates, and thereafter, towards the discharge of any liability to repay the principal sum or any other liability to the qualifying lender in respect of that loan or (insofar as not already covered by benefit payments) any of the other loans.

5. Territorial Extent and Application

This instrument applies to Great Britain.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 This instrument clarifies how excess mortgage payments deducted from benefit entitlement and paid direct to lenders should be treated. It makes no changes to the amounts payable but sets out, in line with the principles underpinning the introduction of the standard interest rate announced in 1995, that any payments in excess, resulting from the actual rate being lower than the standard rate, should be used only to credit a claimant’s loan account. While lenders have been advised to inform customers that these excess payments will be applied to the customers’ mortgage accounts, and while in most cases this will meet with customers’ agreement, an issue may arise if a customer does not wish the money to be used in that way. Lenders would welcome legal clarity as to what should happen in that situation.

7.2 The amending regulations ensure that any excess is applied first to any arrears of mortgage interest and then towards repayment of the principal sum or any other liability in respect of that loan.

7.3 Until recently, very few, if any, customers asked for the excess to be paid to them by lenders. The value of these excess payments has increased over time and in some cases is likely to be very high, particularly for those who have mortgages with interest rates at or slightly above the current Bank of England base rate of 0.5%. Customers will also be aware of the impact of any mortgage payments made to their accounts as a result of discussions with their lenders and through their annual mortgage statements. As a result, the Department for Work and Pensions is experiencing a significant increase in enquiries from lenders, the Council of Mortgage Lenders, and customers approaching Benefit Delivery Centres about these excess payments. While no official records are kept on the numbers of enquiries made to Jobcentre Plus and Pensions Centres on this matter, informal information suggests that there are on average over 200 enquiries a week.

7.4 Lenders are concerned that an increasing number of customers could go into arrears if excess mortgage payments are paid to customers instead of being applied to their mortgage accounts as intended. This could be, for example, as a result of lenders' accounting processes which tend to calculate mortgage balances yearly in arrears; or, where customers hold repayment mortgages and cannot afford to pay the capital element; or, where the eligible housing costs for support for mortgage interest are based on a sum lower than the loan outstanding. Some lenders have also suggested that they may be inclined to withdraw from the mortgage interest direct scheme altogether if this matter is not resolved as calculating and refunding excess payments would be administratively complex and costly. A move from lenders to withdraw from the mortgage interest direct scheme could lead to repossessions if customers are then paid their support for mortgage interest direct and do not pass it on to their mortgage lenders.

7.5 These regulations ensure that excess housing costs payments are credited to claimants' mortgage accounts, as always intended, and that customers would have no legal grounds to draw excess payments from their mortgage accounts to use for other purposes. The regulations reflect existing over-arching policy aims to prevent repossessions, and the published principle underpinning the introduction of the standard interest rate.

7.6 Those affected by changes made by this instrument are claimants who have a sum deducted from their benefit entitlement (income support, income-based jobseeker's allowance, income-related employment and support allowance and state pension credit) representing their entitlement to help with housing costs, which is paid direct to their lenders, and who have an actual interest rate that is lower than the standard interest rate. The majority of customers receiving help towards their mortgage interest costs have it paid direct to lenders.

7.7 Based on a small sample of data from the Council of Mortgage Lenders, it is estimated that 92 per cent (200,000) of current customers receiving help through the support for mortgage interest rules have mortgage interest rates below the current standard interest rate of 6.08%. This data also indicates that 20 per cent of support for mortgage interest customers are currently in arrears with their mortgage payments, suggesting that around 40,000 customers with mortgage rates below 6.08% currently have arrears on their mortgage accounts. This implies that some 160,000 customers with mortgage rates below 6.08% currently have no arrears on their mortgage accounts. It is not known how many of these customers may have built up arrears not captured on their mortgage accounts, for example by increasing their borrowing on the same loan to service their mortgage liabilities.

7.8 The limited data sample suggests that of the customers with mortgage rates below 6.08%, over half are currently receiving support for mortgage interest payments that are at least 50 per cent higher than the actual interest due to lenders on the eligible loan. However, even customers in this position with no arrears do not necessarily receive help towards their total mortgage interest payments where part of the loan is ineligible (taken out for some purpose other than purchasing the property or making certain home improvements). These regulations will not allow excess mortgage interest to be applied to these ineligible loans.

Consolidation

7.9 A consolidated text will be available online via the DWP website in due course. The website is accessible to the public free of charge: http://www.dwp.gov.uk/ .

7.10 It is the Department's intention to consolidate the Claims and Payments Regulations when time and resources allow.

8. Consultation outcome

8.1 There has been no formal public consultation on this instrument because the Secretary of State for Work and Pensions has decided that the matter is sufficiently urgent to necessitate legislation being made as soon as possible (as explained at section 7 – policy background – and in particular paragraphs 7.3 and 7.4); in addition to which, consultation is not appropriate as the regulations reflect longstanding policy and there is no scope for the proposed legislation to be influenced. Informal discussions have, however, taken place with the Council of Mortgage Lenders.

8.2 The urgency is due to increasing numbers of enquiries from customers on this matter, some of whom have been requesting refunds, and the impact on the number of repossessions and more generally on public finances if a significant number request refunds of the excess mortgage interest to be used for purposes other than reducing mortgage liabilities.

8.3 Because of the urgency (see paragraphs 7.3 and 7.4), the Secretary of State has decided that it is inexpedient to refer proposals in respect of the regulations to the Social Security Advisory Committee prior to making the regulations. However the instrument will be referred to the Social Security Advisory Committee as soon as practicable after it has been made. The Department will consider carefully any advice or recommendations made by the Committee.

9. Guidance

9.1 Guidance will be made available to front line decision makers and benefit processors through the internal website of the Department for Work and Pensions.

9.2 The Department for Work and Pensions will also ensure that the changes are publicised through Directgov so that customers, mortgage lenders and welfare rights advisers are aware of them. These groups are already aware of the principle that support for mortgage interest is intended to be used to reduce mortgage liabilities for individuals.

10. Impact

10.1 There is no direct impact on business, charities or voluntary bodies, but the changes should lead to fewer enquiries and requests to mortgage lenders for refunds of excess mortgage payments which are administratively complex and costly.

10.2 The impact on the public sector is negligible as it will primarily involve minor changes to the provision of advice.

10.3 A full impact assessment has not been prepared for this instrument.

11 Regulating small business

The legislation does not apply to small business.

12 Monitoring & review

12.1 The amending regulations are intended to ensure that the law works in the way it was always intended to – that is that any excess mortgage interest payment is credited to a claimant's mortgage account and cannot be withdrawn and used for other purposes. The Department for Work and Pensions is continuing to improve its understanding of the impact of support for mortgage policy reforms on repossessions, and will seek to include any information that it can on this in the forthcoming evaluation.

13. Contact

13.1 Nina Young at the Department for Work and Pensions (Tel: 0207 449 5351) or email: nina.young@dwp.gsi.gov.uk can answer any queries regarding the instrument.