Association of AMI Mortgage Intermediaries

AMI Factsheet: The right of set off

Introduction

This factsheet has been prepared by the Association of Mortgage Intermediaries to highlight how lenders may recover non-mortgage debt and how the Financial Services Compensation Scheme (FSCS) will consider an offset mortgage in the event of a claim being made.

Lenders' terms and conditions will differ and they will have several clauses relating to the recovery of debt. This factsheet only addresses 'all monies charges'.

There are several considerations that advisers need to make if recommending an offset mortgage. This factsheet is not intended to provide an exhaustive list, nor is it intended to prioritise one factor over another, as this will ultimately depend on each individual's needs and circumstances.

All monies charges

Some lenders include an 'all monies charge' in their terms and conditions to give them the right to secure unsecured debt such as loans, credit cards and overdrafts on mortgaged properties.

These clauses allow a lender to repossess a borrower's home if they have failed to keep up with payments on any non-mortgage debt that a borrower may have (or have in the future) with the same lender.

A borrower may only be made aware of this clause during the conveyancing process as it is not often noted within the mortgage offer.

Offset mortgages

One of the main attractions of an offset mortgage is its tax efficiency, with the savings balance being used to reduce the amount of interest payable on the mortgage. They can be beneficial for two main reasons:

- a higher rate of interest may be payable on a mortgage than would be received on savings and therefore using savings, or even cash that is only available for a short period, to reduce the mortgage balance may improve the borrower's net position.
- interest received on savings above the Personal Savings Allowance are subject to income tax but because no interest is actually received in offset arrangements, it can be particularly tax efficient for higher rate taxpayers. The tax treatment means that any savings in an offset account effectively produce a return at the mortgage rate, which is grossed up at the relevant marginal tax rate.

When recommending an offset mortgage there are however several factors to take into account other than cost. One consideration is how the offset facility is structured, i.e. whether the savings will be held in a separate account or if they are combined with the mortgage debt to operate as one large overdraft.

Current FSCS arrangements

Set off is not applied by the FSCS. This means if a depositor owes a bank money, the debt is not set off against a positive balance when calculating the amount of the protected deposit. Instead the FSCS will pay compensation as a gross payout up to the £85,000 limit (or the £1 million limit in the case of "temporary high balances" where certain payments have been received such as an inheritance proceeds).

Negative balances such as overdrafts, credit cards and certain types of offset mortgage accounts will be excluded by the FSCS.

However, under insolvency law, a remaining deposit balance over £85,000 may be set-off against any debts in the liquidation, meaning consumers' debts will be reduced by that excess amount.

The basis of this system is to help speed up FSCS payments and ensure that eligible depositors do not lose liquidity in the event of a default, thereby providing consumer with greater security regarding their deposits.

FSCS and offset mortgages

The outcome of a compensation claim will be dependent on the structure of the offset mortgage.

If a deposit account is separate from the mortgage balance, it would be dealt with separately and compensation would be calculated on a gross basis.

If the deposit account is combined with the mortgage account and operated as one large overdraft, the FSCS would have to treat it as an overdraft and no compensation would be payable.

If the accounts are separate the FSCS would pay compensation up to the limit and the remainder would automatically be set-off against the mortgage under insolvency law.

Summary

Whilst lenders have discretion in exercising the all monies charge, firms should be aware if a contract includes one and to make clients aware. Firms may also wish to consider the inclusion of this clause in a recommendation, particularly if a client has significant outstanding unsecured debt with the same lender which may place them at risk.

Careful consideration needs to be given to how the FSCS will treat a compensation claim when advising on offset mortgages. Firms need to be clear that they understand the structure of the product being offered. If there is a risk to a client's savings in light of the product's structure then these must form part of the decisions with the client to establish if the offset mortgage is suitable for their needs and circumstances.

Useful support material

The Financial Services Compensation Scheme has further information on compensation limits and temporary high balances.

It also sets out the right of set off in respect of offset mortgages, which can be found in the deposits Q&A section of the website.