Statement on mortgage prisoners

July 2020

Contents

1 Summary

1.1 This Statement explains the work we have carried out to explore what further interventions may help mortgage prisoners. We recognise the challenges faced by mortgage prisoners and the impact of the pandemic health crisis. We have taken action to support lenders providing options for mortgage prisoners which we outline below. We are today announcing a consultation on further action to support some mortgage prisoners with options, and to protect interest-only and partial capital repayment (part-and-part) customers whose mortgages have recently matured or will mature during the next 12 months given the coronavirus (Covid-19) pandemic impacts. We also set out the actions we have already taken and the other support that is available to help mortgage prisoners.

1.2 We want to see a market for mortgage lending which provides good outcomes for customers and enables choice and competition. We found in our Mortgages Market Study (MMS) that competition is working in this market, switching levels are high, there are a range of products on offer and apparent competition on headline rates between lenders. The MMS found there were over 8 million mortgage borrowers with authorised lenders. Many of these borrowers benefit both from being able to get a new better deal from their current lender (internal switching) or from a new lender (external switching). But some borrowers don't switch where they are able to and would benefit from doing so (inactive consumers), and some can't switch. We call borrowers who can't switch despite being up to date with payments and, depending on their loan and borrower risk characteristics, are potentially paying more than they need to **'mortgage prisoners'**.

1.3 Borrowers can find they are unable to switch to a new mortgage deal because their circumstances have changed since they took out their mortgage or last switched, perhaps because of a significant life event such as losing their job. Most of the difficulties in switching facing mortgage prisoners can be traced back to the major changes to lending practices during and immediately after the 2008 financial crisis, and the subsequent regulatory response aimed at preventing a return to past poor practices (eg self-certification of income). Some firms exited the market or ceased to write new mortgages, and many firms approached lending with reduced risk appetites. The reduced risk appetites were likely partly in response to their own risk decisions and partly in response to the regulatory changes which were implemented to prevent lenders from providing mortgages which could be unaffordable and to reduce the likelihood and impact of lenders failing.

1.4 The MMS found that the majority of mortgage prisoners had mortgages held by regulated lenders who are not lending to new customers (inactive lenders) and unregulated entities. We refer to these collectively as inactive firms. Customers of inactive firms, that cannot switch with their existing lender, can only switch to a new deal if they can find an active lender willing to lend to them. For those borrowers that are not within the lending appetite of active lenders, this switching option is not available.

1.5 In contrast, borrowers with an active lender typically have the advantage of being able to get a new deal from their current lender. The MMS helped deliver this, as it prompted an industry wide commitment from the vast majority of active lenders to offer a new deal to existing customers where they ask to switch (and meet the criteria for this, for example they are not in arrears). Our rules allow lenders to offer new deals to existing customers without undertaking an affordability assessment, providing they are not borrowing more. This means effectively there are likely to be few mortgage prisoners with active lenders.

1.6 Borrowers without an internal switching option (such as those with inactive firms) may be mortgage prisoners where they cannot pass an affordability assessment with a new lender or they have loan/borrower characteristics that mean they do not meet lender credit risk appetites. We understand that these borrowers may be in a difficult and stressful situation as they are unable to find a new better deal, despite being up to date with payments.

1.7 In June 2020, we undertook **new analysis** to understand more about borrowers with inactive firms. We focused on this group as the majority of mortgage prisoners are with inactive firms. We know, from data we collected in September 2019, that there were around 250,000 people who had mortgages held by inactive firms. Our new analysis found 125,000 (50%) of the borrowers with inactive firms have loan/borrower characteristics that mean they would not meet lender credit risk appetites, making it difficult for them to switch to new lenders. Of these, 55,000 are up to date with their mortgage payments and 70,000 are not up to date with these payments. Our analysis indicates that the other 125,000 are potentially able to switch but are not switching, sometimes for a variety of reasons. We discuss each of these groups in turn below.

Those unable to switch

1.8 Of the 125,000 who would find it difficult to switch, we then looked further at the 55,000 of these who are up to date with payments. Of the 55,000 borrowers, we estimate that around 30,000 borrowers are the most impacted. This is because they are potentially paying more than they need to, depending on their loan and borrower risk characteristics, as they are on a higher reversion rate (the interest rate payable once an introductory deal ends, usually a standard variable rate (SVR)) compared to the current lowest available SVR.

1.9 Our new analysis looked at whether the 55,000 borrowers are being harmed due to the price they are paying and, if so, by how much, by considering the price they pay as compared to those with similar risk characteristics with active lenders. We have found that borrowers with inactive firms who are up to date with payments and cannot switch are paying slightly more (0.4 percentage points) than similar borrowers in the active market, when taking account of their risk and loan characteristics. Therefore, we conclude the prices they pay are broadly the same as borrowers with similar risk and loan characteristics in the active market.

1.10 Nevertheless, we recognise that many of these borrowers are unable to switch. We have, however, sought to work to unlock greater levels of switching and make it easier to switch for some borrowers who may be currently unable to switch. Following the MMS, **we have taken a number of steps to help borrowers who cannot switch**. Most notably, we introduced a new modified affordability assessment to help remove the potential regulatory barriers to switching for mortgage prisoners and other borrowers who are up to date with payments. The modified affordability assessment allows lenders to simplify their approach to taking on new customers looking to switch to a more affordable mortgage.

1.11 Unfortunately, the disruption caused by coronavirus has meant that lenders' plans to offer new switching options to mortgage prisoners have been delayed. We are committed to working with industry through our Implementation Group to see these switching options being offered in the coming months. Worsening market conditions are likely to impact on firms' risk appetites and the availability of switching options but we still expect our modified affordability assessment to help some mortgage prisoners. In addition to our modified affordability assessment, we have also explored what else we can do to help borrowers who are unable to switch. We are **consulting on new rules that will make it easier for closed book (i.e. books not lending to new customers) borrowers to switch to a mortgage with a new active lender within the same financial group.**

1.12 In addition to those borrowers with inactive firms who cannot switch, we are also concerned about some other borrowers, including those who are able to switch and would benefit from a new deal but are not switching. We also consider those who are not up to date with their mortgage payments as they may be struggling financially and are unlikely to be able to switch. Another group we are concerned about are those with interest-only or part-and-part mortgages without a plan to repay the capital when the mortgage matures, as this potentially puts their home at risk. The final group we consider are those whose mortgages are held by unregulated entities. We consider the size each of these groups of borrowers and what steps we have taken to help them below.

Those who are able to switch but are not switching

1.13 As well as the 125,000 borrowers who would find it difficult to switch, our analysis also found another 125,000 borrowers with inactive firms who are able to switch but are not switching. Our new analysis found that out of the 125,000 borrowers who can switch, there are up to 88,000 borrowers with inactive firms who could gain from a new introductory deal.

1.14 In the MMS, we found 800,000 borrowers with active lenders that would be able to and benefit from switching to a new deal, either with their current lender or a new lender, but are not switching. In March 2020, we undertook research to understand more about such borrowers. We planned to consult on proposals to help mortgage borrowers who do not switch, but timelines for this work were delayed as we have needed to prioritise our response to the coronavirus crisis. We expect to **consult on potential remedies to help these borrowers** in the winter, subject to our continuing response to the crisis.

Those who are not up to date with payments

1.15 Our latest analysis found that of the 250,000 borrowers mentioned in paragraph 1.7, there are around 70,000 borrowers who are not up to date with their mortgage payments. These borrowers will be unable to switch to a new deal as lenders do not normally lend to those already in payment shortfall but we do not consider them mortgage prisoners. Nonetheless, where a borrower is not up to date with their mortgage payments, it is important that they are treated fairly. We have detailed rules setting out how we expect firms to do this. Firms, including those who

administer mortgages owned by unregulated entities, should explore all relevant options with borrowers. To provide further support for borrowers with inactive firms who may be struggling financially, we are **working with the Money and Pensions**

Service (MaPS) to create specific online information and a dedicated phone line as a key source of information and advice.

Those with interest-only or partial capital repayment (part-and-part) mortgages

1.16 We found the majority (57%) of the 250,000 borrowers have interest-only or part and-part mortgages. We have been concerned to ensure that all borrowers with interest-only mortgages have adequate plans in place to repay their mortgage when it matures. The coronavirus has had a significant impact across markets including on investments, remortgaging, and the housing market. The economic conditions resulting from the coronavirus crisis are likely to have frustrated the repayment plans of some borrowers with maturing interest-only mortgages. Given this, **we are consulting on new guidance that firms should allow borrowers to delay repayment of the capital at maturity on interest-only and part-and-part mortgages up to 31 October 2021**, provided borrowers are up-to-date with payments and continue to make interest payments.

Those whose mortgage is owned by an unregulated entity

1.17 Some stakeholders have raised concerns that the boundary of regulated activities (known as the perimeter) could affect the fair treatment of borrowers whose mortgages are owned by an unregulated entity. There are some cases where an extension of the perimeter would give us regulatory reach or improve our reach. In practice, however we have found that currently in the majority of cases, where books have been sold to unregulated entities they have delegated key decision-making responsibilities on interest rate changes and forbearance, to regulated firms.

Next steps

1.18 We are committed to making it easier to switch for some mortgage prisoners so that they might obtain a better deal. We expect that some mortgage prisoners, along with other borrowers, will benefit from the modified affordability assessment and our new consultation proposal on intra-group switching.

1.19 In the face of the coronavirus crisis, we have been looking to ensure that borrowers with payment difficulties receive the necessary support. Our guidance applies to all borrowers, including mortgage prisoners. In the same way, our new proposed coronavirus intervention to help maturing interest-only and part-and-part borrowers, should benefit some mortgage prisoners alongside other borrowers.

1.20 We will also continue our discussions with the Government, consumer groups and other stakeholders to explore other options for mortgage prisoners.

2 Background

2.1 The UK mortgage market is ever changing – in terms of the firms that are actively lending, the deals that borrowers can access, and the risk appetite of lenders.

2.2 In the current market, most mortgage products include a short-term introductory deal usually at a fixed interest rate, after which the rate changes to a reversion rate, such as the lender's SVR. Depending on the borrower's circumstances, it is usually in their interest to switch to a new deal at this point as the reversion rate is normally a higher interest rate.

2.3 Many borrowers benefit both from being able to get a new deal from their current lender (internal switching) and the option of moving to a new lender (external switching). But some borrowers don't switch where they are able to (inactive consumers) and some can't switch. We call borrowers who can't switch despite being up to date with payments and, depending on their loan and borrower risk characteristics, are potentially paying more than they need to, '**mortgage prisoners'**.

2.4 Borrowers can find themselves unable to switch to a new mortgage due to:

- changes to lending practices
- regulatory changes
- changes to their own circumstances

2.5 Lenders' risk appetites can change if they decide to reduce their exposure to credit risk where they are worried about some customers' ability to repay mortgages. For example, the financial impact of the coronavirus crisis has led to lenders removing many products from the market, particularly higher loan to value products since the end of March. A lack of available funding or an increase in the cost of funding can also lead to lenders reducing their exposure to credit risk.

2.6 Our regulation, begun under our predecessor, the Financial Services Authority in 2004, has also changed. In addition to the major changes to lending practices during or immediately after the 2008 financial crisis, the subsequent regulatory response, which aimed to prevent a return to past poor practices like self-certification of income, left some customers unable to switch to a cheaper mortgage deal.

2.7 As well as borrowers affected by changes in lending practices and regulation after the financial crisis, we know there are others who may be unable to switch. This could be, for example, because their circumstances have changed since they took out their mortgage or last switched, perhaps because of a significant life event such as losing their job.

The Mortgages Market Study

2.8 Our objectives are to ensure relevant markets, including the mortgage market, function well, securing an appropriate degree of protection and promoting competition for borrowers. In December 2016, we began a Mortgages Market Study (MMS), into first-charge residential mortgages, to understand how well important aspects of this market were working after our Mortgage Market Review that followed the 2008 Financial Crisis.

2.9 The MMS, which we concluded in 2019, found the market works well in many respects. But that there were some areas where the market could work better. Overall, we found switching in the mortgage market is high, with over three quarters of borrowers switching to a new mortgage deal within 6 months of moving onto a reversion rate. But we found that some borrowers either do not switch when they could or are not able to switch, despite being up to date with their mortgage payments.

2.10 We refer to borrowers who can't switch despite being up to date with payments and, depending on their loan and borrower risk characteristics, are potentially paying more than they need to as 'mortgage prisoners'. We did not include borrowers in payment shortfall in this group. This is because our rules already set out how we expect firms to treat borrowers in payment shortfall fairly. This includes requirements on firms to make reasonable efforts to agree with borrowers how that their payment shortfall can be cleared and consideration of options to assist borrowers in payment difficulties.

2.11 In the MMS, we found that most active lenders make use of the flexibility in our rules that allows lenders to offer new products to existing borrowers (internal switch), providing they are not borrowing more, without undertaking new affordability or credit checks. However, we also found that a small number of borrowers with currently active lenders (10,000) appeared to lack switching opportunities (based on data from 2016). This was because their particular lender would not offer them an internal switch without an affordability check and they had borrower/loan characteristics that meant they would not be offered a new deal by a new lender.

2.12 In our MMS interim report, we sought to address the barriers that borrowers with active lenders faced to switching. We suggested that active lenders could volunteer to approve applications for an internal switch from all customers currently on a reversion rate that also meet certain criteria eg are up to date with payments. Lender trade bodies responded by facilitating a voluntary agreement, covering around 97% of the market, to offer these borrowers an alternative deal where they meet certain criteria (for example they are not in arrears, and they have a minimum of 2 years or £10,000 left on their mortgage).

2.13 The MMS also found a greater number of those unable to switch are customers of inactive lenders and unregulated entities (we refer to these collectively as inactive firms). In the UK, mortgage books can be sold on to unregulated entities for example, if a lender's business model involves securitising mortgage books and selling them to investors. It can also result from the sale of the mortgage books of failed lenders.

Inactive lenders: firms authorised for mortgage lending but are no longer lending. Borrowers with these firms cannot switch to a new deal with the firm that owns their mortgage (internal switch) as these firms are not lending so do not offer new deals.

Unregulated entities: firms not authorised for mortgage lending. Borrowers with these firms cannot switch to a new deal with the firm that owns their mortgage (internal switch) as these firms are not lenders.

2.14 The barriers to switching for those borrowers with an inactive firm are that they cannot switch internally (with their current lender) as the firm that owns their mortgage is either not a lender (unregulated entity) or is a lender but is not offering new deals (inactive lender). Therefore, the industry voluntary agreement, where active lenders have agreed to offer their existing customers alternative deals where they meet certain criteria, does not cover these firms and it does not help these borrowers. This means borrowers with inactive firms can only switch to a new deal if they satisfy the eligibility criteria of other lenders currently active in the market.

3 Data analysis on borrowers with inactive firms

3.1 In the MMS, we held limited data on mortgage books with unregulated entities as these firms did not have to submit account-level data to us. Following the MMS, we collected further data to understand more about borrowers who have a mortgage held by an unregulated entity and we also looked at the data we collect from closed mortgage books. In January 2020, we published new data which found that there were around 250,000 borrowers with in closed mortgage books or have mortgages owned by firms that are not regulated by us (in September 2019).

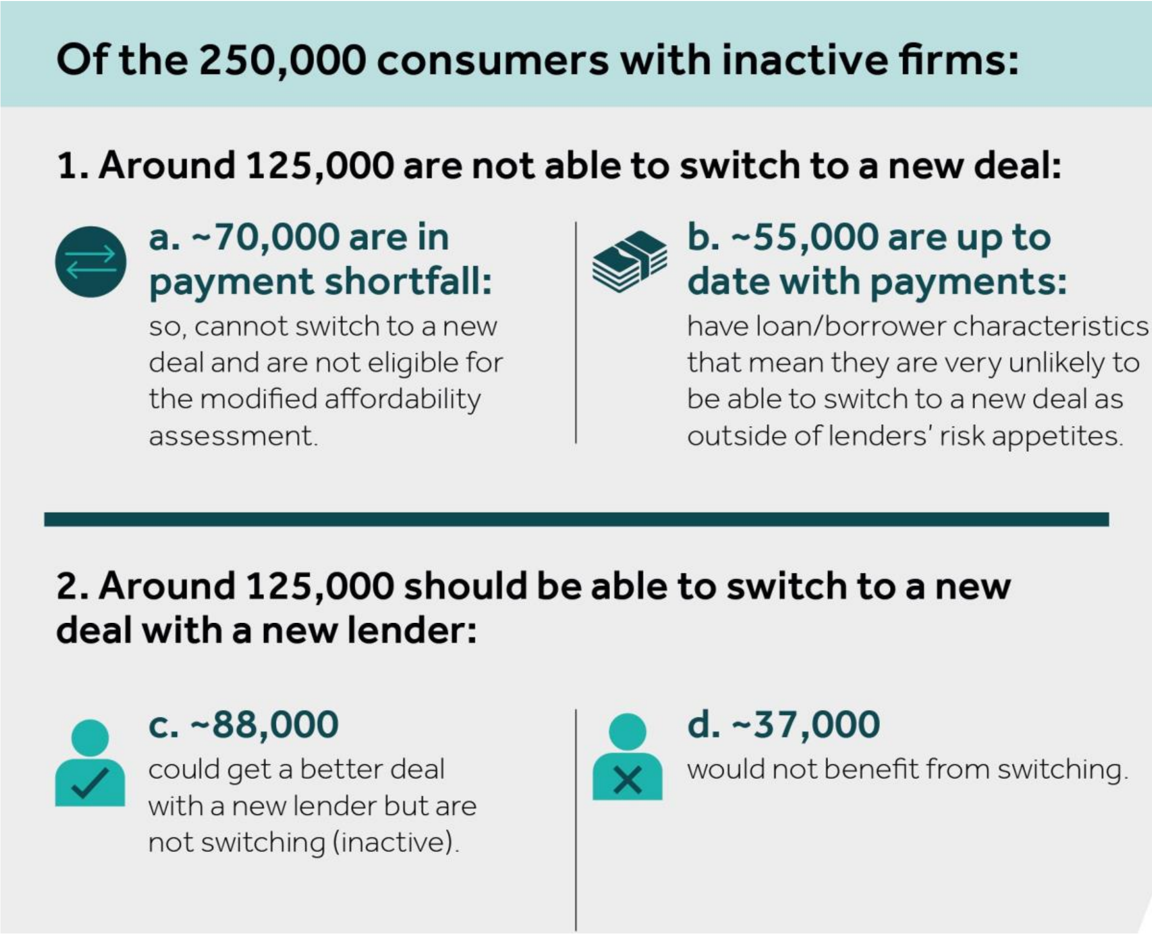
3.2 We have subsequently undertaken new analysis of this data to understand more about borrowers with inactive firms, including mortgage prisoners, to enable us to assess whether and if so what further regulatory remedies are needed. We have focused on this group as the MMS found that the majority of mortgage prisoners are likely to have mortgages held by these inactive firms. Also, the voluntary agreement has ensured that most borrowers with active lenders should be able to switch to a new deal with their current lender (as long as they meet the criteria).

3.3 In our latest analysis undertaken in June 2020, we have supplemented our data on the 250,000 borrowers whose mortgages are held by inactive firms with additional information from a credit reference agency for a 10% random sample of UK borrowers. This data gave us information on different borrowers' risk characteristics including their credit scores, frequency and value of missed payments across all credit products, and total secured and unsecured debt volumes. This has allowed us to get a better picture of how they would be considered by a potential new lender i.e. whether they would be able to get a new deal with lenders currently active in the market.

3.4 We applied advanced statistical techniques to our existing data on borrowers' ages, loan to value (LTVs), loan amounts, and other mortgage-specific characteristics in combination with this credit reference agency information. This allowed us to better identify borrowers with similar risk and other characteristics across inactive firms and active lenders, and compare their outcomes on a like-for-like basis.

What we found

Figure 2: The main findings of our analysis (this is based on data from 2019):



4 Borrowers who are unable to switch to a new introductory deal

4.1 Some borrowers with inactive firms are unable to switch to a new deal with the firm that owns their mortgage, in contrast to most borrowers with active lenders (who should benefit from the voluntary agreement). These borrowers with inactive firms can therefore only switch if they are offered a new deal with a new lender.

4.2 Our modified affordability assessment is intended to make it easier for borrowers to switch to a new deal with a new lender. However, as lending is a commercial decision, these borrowers with inactive firms will still be unable to switch to a new lender where they have borrower or loan characteristics that mean they would not meet lender criteria in the open market.

4.3 When considering whether to offer a new mortgage deal and what price to charge, lenders will consider the risks posed by a borrower; for example, a high LTV mortgage and an impaired credit history present a higher risk. A borrower who the lender thinks is higher risk (for example, more likely to default on the mortgage) will either not be offered a mortgage or be offered a higher interest rate (than borrowers with lower risk mortgages). For example, a higher LTV mortgage is likely to have a higher interest rate than a lower LTV mortgage. As an illustration, the average 2year fixed rate for a 95% LTV mortgage is 3.94% whereas the average 2-year fixed rate for a 60% LTV mortgage is 1.69% (as of 26 June 2020). So, where a mortgage prisoner has a higher LTV mortgage, if they are able to find a new mortgage deal with a new lender, the interest rate on that deal is likely to be higher than that offered to a mortgage prisoner with a lower LTV mortgage. Where borrowers have interest-only mortgages without a sufficient plan for repaying the capital at the end of the term, they are also likely to be considered high risk and outside the risk appetite of active lenders.

4.4 Another reason why borrowers with higher risk characteristics with inactive firms may be unable to switch to a new lender, is that it is more expensive for a lender to take on riskier mortgages. A sustainable mortgage market needs lenders to lend responsibly and manage the risks they take on. Prudential regulation, whether by us or the Prudential Regulation Authority, is designed to ensure this. Prudential regulation requires more capital to be held for higher risk loans so it is more expensive for lenders to take on these loans. The reason for this capital is to absorb potential losses from their mortgage books (and other assets). The minimum amount of capital that lenders need is calculated using a risk-based system. An example of this is that mortgages with a high LTV (which is one form of risk) require the lender to hold a higher capital amount. The cost of lending to higher risk borrowers may dis-incentivise lenders from seeking out such borrowers. Lenders may choose to increase prices for these borrowers, to cover the additional risk but this may itself constrain affordability for borrowers.

Analysis on borrowers with inactive firms unable to switch

4.5 Our new analysis undertaken in June 2020 found around 125,000 (50%) borrowers with inactive firms have characteristics that would make it difficult for them to switch as they meet one or more of the following criteria:

- not up to date on mortgage payments

- loan/borrower characteristics below high-level lending standards
- credit score below the bottom 1% of the population of borrowers accepted by active lenders in the past 18 months (conditional on LTV, loan size and other basic risk factors)
- combination of recent consumer credit behaviour, risk characteristics and loan characteristics that are not the same as those borrower/loan characteristics of recent customers. This means that these borrowers have borrower/loan characteristics that place them outside current lender risk appetites

4.6 Of these 125,000 borrowers, there were 55,000 borrowers who are up to date with their payments. We looked at what interest rates they are paying to explore whether they are potentially paying more than they need to, although this will be dependent on their loan and borrower risk characteristics (see section below for analysis that accounts for these characteristics).

4.7 We initially assessed whether these borrowers are potentially paying more than they need by comparing the rates they pay with the lowest SVR currently offered in the market. This was 3.35% in June 2020. However, it is important to note that this illustrative benchmark does not take account of a customer's loan/borrower characteristics (risk profile) and lenders' risk appetites. As context, the average SVR currently available in the market for all borrowers was 4.49% as of June 2020.

4.8 In September 2019, when the data was collected, 46% of the 55,000 borrowers were paying 4% or below. Following the March 2020 Bank of England base rate cuts (of 0.65%), these same borrowers should now be paying 3.35% or below as base rate cuts have been passed on where possible. Therefore the remaining 54% of the 55,000 (around 30,000 borrowers) are unable to switch (as they have borrower/loan characteristics that place them outside current lender risk appetites) despite being up to date with payments and are paying a higher reversion rate than the current lowest available SVR in the market. We set out below what interventions we have explored to address this issue where borrowers are unable to switch to a better deal.

The modified affordability assessment

4.9 In October 2019, we acted to remove the potential barriers in our rules to borrowers switching to a more affordable mortgage. This was intended to make it easier for eligible borrowers to access a better deal, including helping borrowers with inactive firms, some of whom may be mortgage prisoners, switch to an active lender. We introduced a new modified affordability assessment to enable lenders to simplify their approach to borrowers who are up to date with payments and are looking to switch to a more affordable mortgage.

4.10 Lenders can choose whether to apply the modified affordability assessment as lending is a commercial decision. The success of these changes therefore depends on a number of lenders offering new switching options to these borrowers. We set up a Mortgage Prisoners Implementation Group to help the industry's preparations to take advantage of the modified affordability assessment and also promote greater lending flexibility by firms other than by using the modified affordability assessment. We recently announced that we wanted to hear from mortgage intermediaries who are willing to be on a list of intermediaries who will work with mortgage prisoners to help them find switching options. We recognised that these initiatives will not help all mortgage prisoners, particularly where borrowers have circumstances that are outside the risk appetite of many lenders. However, we expected some firms would want to take advantage of the flexibility of these rule changes and lend to some of these borrowers.

4.11 Since we introduced these rule changes, we have seen significant changes to the mortgage market as a result of coronavirus. Lenders have removed large numbers of products from the market since the beginning of March and have granted around 1.9 million mortgage payment deferrals. Therefore, lenders have largely been focused on supporting existing customers rather than lending to new ones. This has influenced the impact of our rule changes that introduced the modified affordability assessment. Due to the current economic climate, it will take more time for the market to be able to offer the range of switching options we had expected. Therefore, on 1 May 2020 we changed our rules to extend the date by which we expect firms to contact relevant borrowers about switching options by 3 months (to 1 December 2020). We are committed to working with industry to see switching options available by the end of the year. Although worsening market conditions as a result of coronavirus are likely to impact on the extent of switching options available, we still expect our modified affordability assessment to help some eligible mortgage prisoners. In addition to our modified affordability assessment, we have also explored what else we can do to help borrowers who are unable to switch.

New intra-group switching proposal

4.12 Following on from our modified affordability assessment, we are now consulting on rule changes that should make it easier for some mortgage borrowers to switch to a new deal. The mortgage borrowers who would be eligible to benefit from this change include some borrowers with inactive firms, some of whom may be mortgage prisoners.

4.13 Our consultation proposes a rule change to remove potential barriers in our rules to closed book customers switching to a new mortgage with a firm that sits within the same group as their current closed book lender. By closed books, we mean that the firm that owns the mortgage book does not lend to new customers. They may offer new deals to existing customers but these can be at higher rates than firms lending to new customers. This could be due to a number of reasons, including the differences in the borrower risk profiles and the associated costs that follow from this (for example, in meeting prudential requirements). We propose to amend our responsible lending rules to allow lenders to treat borrowers in a closed book that is within their group in the same way as they would treat their existing customers who want to switch internally. It would mean that lenders would not be obliged to undertake a standard affordability assessment, or use the modified affordability assessment, for these borrowers, if there is no further borrowing and no change to the terms of the mortgage that is likely to be material to affordability. Lenders could use the modified affordability assessment for these borrowers but this requires system changes and the coronavirus has delayed these changes. Therefore, we believe this rule change should make it easier for some eligible borrowers, including some mortgage prisoners, to get a new mortgage deal.

4.14 These consultation proposals should help some borrowers with inactive firms, including mortgage prisoners. We estimate that around 25,000 borrowers in these closed books could potentially benefit from switching to the active lender. However, the total number who are likely to switch and benefit from this proposal is unclear. Any increase in switching would depend on borrowers' willingness to respond, whether lenders choose to make use of this rule change, and whether these borrowers qualify for the deals available (i.e. are up to date with payments and are within lenders' credit risk appetite).

However, we expect some eligible borrowers will benefit from this proposal, and this change is in line with our broader approach of removing regulatory barriers that could unnecessarily restrict borrowers switching to a more affordable mortgage.

Mortgage market pricing

Working with firms on interest rates following the coronavirus

4.15 Following the disruption caused by the coronavirus pandemic, we know that this is a difficult and uncertain time for many mortgage borrowers including mortgage prisoners. So, we have been working with firms to consider a range of issues. Since March 2020, firms have reduced mortgage payments for the vast majority of borrowers on reversion rates, including mortgage prisoners, as the most recent Bank of England base rate cuts have been passed on where possible.

4.16 We have also written to firms managing closed books to reiterate that customers on variable rate mortgages taken out before the financial crisis with higher risk characteristics, must be treated fairly. We have made it clear that firms should be actively reviewing the rates they charge these customers. This supervisory work is ongoing.

New analysis on prices paid by borrowers unable to switch

4.17 Our new analysis also looked at the prices paid by borrowers unable to switch. In the MMS, we found that overall borrower engagement in the mortgage market is high and borrowers are largely getting mortgages that are suitable and affordable. We also found apparent competition on headline rates between lenders. In the final report (March 2019), we concluded that price intervention was not necessary in the mortgage market.

4.18 Our new analysis explores how the rates of the borrowers with inactive firms with characteristics that would make it difficult for them to switch, compare to borrowers with similar characteristics in the wider market. We have done this by comparing the rates this group pays to the rates paid by similar borrowers with active lenders who are now on a reversion rate. We compared them with borrowers with active lenders on a reversion rate with similar characteristics as we cannot compare them with borrowers with active lenders on introductory deals. This is because the borrowers with inactive firms do not have the risk and borrower characteristics that mean they would be likely to be accepted on to a premium new introductory deal by a new lender. We found that the 2 comparison groups of borrowers are similar in terms of a wide range of risk, borrower and loan characteristics.

4.19 We found that on average the 55,000 borrowers with inactive firms who have characteristics that would make it difficult for them to switch (but are up to date with payments) are paying around 0.4 percentage points more than similar borrowers with active lenders who are now on a reversion rate. This means that these borrowers with inactive firms are paying rates that are broadly in line with the price in the active market, bearing in mind their risk and loan characteristics.

4.20 We understand the concerns of mortgage prisoners with inactive firms who are currently unable to switch to a new deal as they do not meet the risk appetite of lenders. Where borrowers are unable to switch, mortgage prisoner consumer groups have called for a price cap on SVRs.

4.21 Before we would consider intervening in any market in this way, we would need to be confident that the intervention is the most proportionate and effective way of tackling that harm. We would have a range of complex considerations that we would need to work through including the scope of any price cap and the extent to which it would affect those customers not benefitting from any cap, the extent of impact on firms' business models and pricing approaches and in some cases their viability, depending on the level at which any cap could be set. We would also need to consider any further unintended consequences of a price cap. We want to first understand how the interventions we have set out in this paper and the related CP ultimately affect mortgage prisoners.

5 Borrowers who are able to switch but are not switching (inactive consumers)

5.1 In the MMS, we found that despite consumer engagement in the mortgage market being high, there are around 800,000 borrowers who do not switch when they would benefit from doing so (inactive consumers). These borrowers are suffering harm as they miss out on average savings of £1,000 per year by not switching to a new deal (based on a new 2-year introductory deal). Our new analysis finds that there are some borrowers with inactive firms that should be able to switch to a new deal and would benefit, but are not switching.

Our new analysis on inactive borrowers

5.2 Our analysis found that approximately 50% of borrowers with inactive firms were similar in terms of risk, borrower and loan characteristics to borrowers recently accepted by lenders. This means that about 125,000 borrowers with inactive firms should be able to find a remortgage deal. They are not mortgage prisoners by our definition as they should be able to switch to a new deal in the market.

5.3 We have also worked to understand whether borrowers in this group who could switch, would benefit from switching. Around 37,000 (around 30%) of these could switch but would not benefit from switching as they are already on a relatively low interest rate.

5.4 Understanding whether the remaining borrowers who could switch would benefit from switching is complex, due to the long-term nature of a mortgage. Compared to the average introductory rates achieved by comparable borrowers, up to 88,000 (around 70%) borrowers who would be able to switch could stand to gain from a new introductory deal, as they could access rates that are least 1 percentage point lower than they are on currently. However, the gains in the longer term will depend on whether borrowers are eligible for a new deal and seek another introductory deal after the initial deal ends or remain on the new lender's reversion rate. On average, the reversion rates for the borrowers with mortgages held by inactive firms are slightly lower than the reversion rates that comparable borrowers are expected to get after their deal period expires. These borrowers will benefit from switching to a new introductory deal, but will only continue to benefit if at the end of the deal period they switch again.

5.5 So, there are up to 88,000 borrowers with inactive firms that would benefit from switching to a new introductory deal (and would continue to benefit as long as at the end of that deal they switch to another new deal) and who are not switching.

Interventions for inactive consumers:

5.6 In the MMS, we identified 800,000 borrowers with active lenders who are able to and would benefit from switching but are not switching. In March 2020, we published our research on inactive consumers and said that we are considering a range of different remedies to address the harm these borrowers face as they could switch and would benefit but are not switching. The research found that reasons why these borrowers do not to switch include a lack of time, a fear of the application process and, for many, relative contentment with their current lender or deal. We were due to publish a consultation paper in Q2 2020 on proposed remedies to address these reasons why borrowers are not switching. This has been delayed due to the coronavirus crisis, but we plan to publish this in the winter, subject to our continuing response to the crisis.

6 Borrowers who are not up to date with payments and others who are struggling with their finances

6.1 Our analysis found that there were around 70,000 borrowers with inactive firms who were not up to date with their mortgage payments in September 2019. We recognise that some of these borrowers may have already been struggling with their finances and that the coronavirus crisis is likely to have had an impact on many of them.

6.2 We set out below the sources of support for those who have been impacted by the coronavirus, those who are not up to date with payments and others who are struggling financially.

Borrowers that have been financially impacted by coronavirus

6.3 On 20 March, we published temporary guidance to lenders and administrators to make clear our expectations about their conduct during the pandemic. We have since published further updated guidance which will expire on 31 October this year (unless it is renewed or updated before then - we are keeping this under review). This guidance ensures borrowers impacted by coronavirus, whether with active lenders or inactive firms, including mortgage prisoners, can benefit from a mortgage payment deferral if needed. A payment deferral is a period of time, agreed with the lender, when a borrower does not have to make mortgage payments. This can take the form of an initial payment deferral and a further full or partial payment deferral (where the firm lets the borrower make reduced payments). Alternatively, the firm can agree a different option with the borrower, where the firm reasonably considers this to be in the best interest of the borrower.

Borrowers who are not up to date with their mortgage payments

6.4 Borrowers who are not up to date with their mortgage payments are not eligible for the modified affordability assessment. Also, general industry practice is not to offer borrowers who are not up to date with payments a new deal (eg they are not eligible for the voluntary agreement) on the basis that other tools/forbearance options are needed to help these borrowers.

6.5 It is important that these borrowers who are not up to date with payments are treated fairly and our rules in MCOB 13 set out how we expect firms to do this. Firms should explore all relevant options for repaying the payment shortfall with these borrowers. This applies also to borrowers with unregulated entities as these entities have to appoint a regulated administrator who is required to comply with MCOB 13.

6.6 The Money and Pensions Service (MaPS) provides easily accessible information to help borrowers make financial decisions and provides access to free debt advice for those that need it. Borrowers who are not up to date with payments with inactive firms, as with all borrowers, can access this information and these services.

6.7 We are working with the MaPS to create specific online information and a dedicated phone line as a key source of information and advice for borrowers with inactive firms. Under our rules, we require relevant borrowers with inactive firms to be contacted about switching options that have arisen as a result of the modified affordability assessment. This MaPS online information and phone line will be in place by the time the market is ready to offer new switching options to mortgage prisoners.

6.8 For those borrowers likely to have switching options, these MaPS resources will signpost to specific brokers that will be able to help. For those borrowers who will not be eligible for the modified affordability assessment (eg where they are not up to date with payments) or eligible but unlikely to have switching options, these MaPS resources will help them find other sources of advice and support.

6.9 The case study below shows what the impact of our intervention and our new rules that introduced the modified affordability assessment would be for a borrower who is able to switch to a new deal once switching options are available:

Case study – borrower able to switch to a new deal

A borrower has a capital repayment mortgage which currently has £100,000 remaining over 15 years with a loan to value of 50%. The borrower is up to date with their mortgage payments.

The borrower receives a letter from the inactive lender that owns their mortgage letting them know that other lenders may be able to offer them a better deal, following changes to the FCA rules. This letter directs them to the MaPS webpage where they go through information provided and are able to find a mortgage intermediary that could help them. They contact the intermediary and they find the borrower a lender that can offer them a new more affordable mortgage deal.

6.10 This other case study outlines where borrowers who are not eligible for the modified affordability assessment as they are not up to date with their mortgage payments can seek help with their situation. The MaPS resources will provide more detailed information for these borrowers.

Case study – borrower with mortgage arrears

A borrower has a capital repayment mortgage which currently has £90,000 remaining over 11 years. The borrower is struggling to repay their mortgage and is £2,000 in arrears.

Our rules require lenders to make reasonable efforts to agree with the borrower how the shortfall can be cleared and consider options to help those in payment difficulties. In this case, the lender agrees with the borrower to extend the mortgage term to help reduce their monthly payments so they can repay the arrears.

If this borrower had wider concerns about their finances, they would be able to access free, expert, and independent advice using the debt advice locator tool on the MaPS website.

Borrowers with considerable unsecured or other debts

6.11 As long as they are up to date with their mortgage payments, borrowers with unsecured or other debts should be eligible for the modified affordability assessment. But some of these borrowers, including some mortgage prisoners, are unlikely to find a switching option as they have loan and borrower characteristics that would be unlikely to meet lender credit risk appetites. For example, lenders will usually be reluctant to offer new customers a mortgage deal where they have considerable unsecured or other debts. We outline the support for these borrowers below and as above the MaPS resources will provide more detailed information for these borrowers.

6.12 The case study below sets out help available for a borrower who has significant unsecured debts.

Case study – a borrower who has unsecured debts

A borrower has a capital repayment mortgage which currently has £115,000 remaining over 10 years. The borrower also has a £20,000 personal loan and credit card debts totalling £26,000, and store cards totalling £6,000. The borrower is struggling to keep up repayments on all of their debts and has missed a number of payments.

Due to the large amount of unsecured debts, mortgage lenders are unlikely to offer the borrower a new deal because they are concerned that the borrower will not be able to make their new repayments

This borrower would benefit from financial help and debt advice. They would be able to ring the MaPS dedicated phone line and speak to a trained advisor. This advisor would be able to explain why the borrower was unable to find a new deal, and pass them to a debt advice service to help them manage the unsecured debts and make monthly repayments more manageable.

7 Interest-only borrowers who face difficulties in repaying the capital at the end of the mortgage term, potentially putting their home at risk

7.1 Where borrowers have interest-only and part-and-part mortgages, unless they can repay the capital that is due at the end of the term, they will breach their contract and might be at risk of repossession action and ultimately lose their home. This is a market wide issue; despite significant reductions in the number of interest-only mortgages (which are down 58% since 2012), there were over 1.3 million interest only (and part and part) mortgages outstanding at the end of 2019 across the mortgage market.

7.2 This is also an issue for borrowers with inactive firms, including mortgage prisoners, who have interest-only or part-and-part mortgages. These mortgages were popular before the financial crisis when many of these borrowers took out their mortgage. We found the majority (57%) of the 250,000 borrowers with inactive firms have interest-only or part-and-part mortgages. There is not up to date information on how many of these borrowers have repayment plans. As noted above, where these borrowers do not have a plan for repaying their mortgage, they are unlikely to be able to switch to a new deal with a new lender.

Interventions and support for interest-only borrowers with no repayment plan

7.3 In 2018, we undertook a thematic review into the fair treatment of existing interest only mortgage customers. This looked at how lenders were working to help customers avoid the potential of non-repayment at maturity. It found that the lenders in the sample had made progress in the fair treatment of these borrowers (since the last review in 2013). They had strategies to contact customers with interest-only mortgages, understand their repayment plans and provide appropriate solutions where no suitable plan is in place.

7.4 Alongside the thematic review we published a leaflet with important information for borrowers with interest-only mortgages and no plan for repaying the capital at the end of the mortgage term. It outlines the steps these borrowers need to take to ensure they have repayment strategies in place, and sources of information or advice to help borrowers that do not.

7.5 The following example shows the intervention and support available for an interest only borrower with no repayment plan:

Case study – borrower with an interest-only mortgage

A borrower has an interest-only mortgage which still has 15 years left on the term. The mortgage was taken out for £250,000 and the current loan to value is 75%. The borrower has no repayment strategy. She was planning on saving using a stocks and shares ISA, but various events have meant this this has never been a priority, or been possible. The borrower has been repaying the interest on the mortgage but has no savings or investments to repay the capital.

The borrower accesses our information sheet online and reads through the different options and calls her mortgage provider to discuss them. As the borrower has called well before the mortgage is nearing the end of its term, the mortgage provider is able to discuss options with the borrower such as switching to a repayment mortgage, or extending the term of her current mortgage. Taking this action has saved the borrower from facing those very difficult decisions, such as selling their home, which may have been the only viable option if they waited to seek help to the end of the term with no other repayment options.

Market disruption due to coronavirus

7.6 We have been working to help borrowers affected by coronavirus including those borrowers with inactive firms. As outlined above, our temporary guidance sets out our view that firms should not commence or continue repossession proceedings against customers before 31 October 2020. This applies to all mortgage borrowers at risk of repossession, whether or not their incomes are affected by coronavirus. It is intended to ensure that during this time of uncertainty and upheaval (and the Government advice on social distancing and self-isolation), borrowers, including those with interest-only mortgages, should not be at risk of losing their homes.

New proposed interest-only guidance

7.7 In our consultation, we are proposing new temporary guidance for maturing interest-only and part-and-part mortgages.

7.8 A number of borrowers, including some mortgage prisoners, have interest-only and part-and-part mortgages that are nearing maturity or have recently matured. Many of these borrowers have plans in place to repay the capital on their mortgages on maturity. The adverse economic conditions resulting from the coronavirus crisis are likely to have frustrated these plans, leading potentially to some borrowers struggling to repay their mortgages. So, we are consulting on draft temporary guidance to help interest-only and part-and-part borrowers who are up-to-date with payments, and whose mortgages are maturing or have matured between 20 March 2020 and 31 October 2021.

7.9 We consider that these borrowers should be allowed to delay repayment of the capital on their mortgage up to 31 October 2021. This is subject to borrowers continuing to make interest payments. It gives borrowers, including mortgage prisoners, more flexibility to repay the capital on their mortgages in potentially less disrupted markets. If borrowers' repayment plans are unaffected by the crisis, it's in their best interest to repay their mortgage.

7.10 We expect some borrowers with inactive firms with interest-only or part-and-part mortgages, including a limited number of mortgage prisoners, to benefit from the proposed guidance. They will benefit if they have a maturing mortgage and can continue to make interest payments.

8 The regulatory perimeter

8.1 Mortgage books can be sold on to a new firm without the borrower's consent. Some stakeholders have been concerned that where mortgages are sold to unregulated entities, borrowers may face an additional worry that they might see a reduction in their protection compared with borrowers whose mortgages are held by regulated lenders.

8.2 We have looked at the level of protection that borrowers in this position have. Our analysis is set out below.

The regulatory perimeter

8.3 Our regulatory reach is set out in legislation, principally the Financial Services and Markets Act 2000. This legislation requires firms undertaking activities set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 to be authorised. The regulatory framework does not prohibit books of mortgages being sold by regulated lenders to purchasers that are not authorised for lending (unregulated entities) and therefore sit beyond the regulatory perimeter. The administration of these mortgages must be undertaken by an authorised (regulated) firm, with unregulated entities appointing firms known as mortgage administrators to do this.

8.4 The mortgage administration activity covers a narrow range of activities (notifying the borrower of changes in interest rates, payments due and other matters where notification is required under the contract, and collecting/recovering payments). Where the purchaser is not regulated, our reach over the regulated administrator may not be sufficient for us to deliver the same level of protection as for borrowers that have mortgages with regulated firms.

8.5 In practice however, we have identified that currently in a majority of cases, the unregulated entities that own mortgage books have not only appointed regulated administrators, as required by legislation, but have voluntarily gone further and delegated key decision-making responsibilities to firms we regulate. This includes decisions on interest rate changes, on forbearance and on repossessions.

8.6 A change in the perimeter could potentially help the relatively small number of borrowers where the unregulated entity has not delegated key decision-making responsibilities to a regulated firm if harms were to arise. A perimeter change could have greater impact if in the future the market were to change and more unregulated entities acted in this way (although the conditions of the original mortgage book sale may restrict this), for example if we were to see more private entities selling their books without such requirements in place.

8.7 Importantly, a perimeter change could not solve all the concerns mortgage prisoners have. As an example, an extension to the perimeter could not guarantee that borrowers are offered a cheaper deal by their existing lender or enable them to switch. More generally, even with a perimeter change, the purchasers of mortgage books are unlikely to have the business model or funding to support the offering of new deals to existing customers.

8.8 Our focus now is working with industry to implement our rule changes and evaluating and assessing the impact of these interventions. We will continue to monitor this issue and to discuss this area and our findings with HM Treasury.

8.9 The perimeter, and any extension to it, is a matter for HM Treasury and Parliament.

9 Conclusion

9.1 We want to see a mortgage market which provides good outcomes for borrowers including enabling effective choice and competition.

9.2 In the MMS, we found apparent competition on headline interest rates and high levels of switching. But we also found that some borrowers (mortgage prisoners) are not able to switch, despite being up to date with their mortgage payments and, depending on their loan and borrower risk characteristics, are potentially paying more than they need to.

9.3 Our new analysis found that on average borrowers with inactive firms who cannot switch and are up to date with payments are paying slightly more (0.4 percentage points) than similar borrowers in the active market, when taking account of their risk and loan characteristics. Therefore, we conclude the prices they pay are broadly the same as borrowers with similar risk and loan characteristics in the active market.

9.4 Nevertheless, we recognise that many of these borrowers are unable to switch. We are committed to making it easier to switch for some mortgage prisoners so that they might obtain a better deal.

9.5 Our rule changes in October 2019 were designed to make it easier for borrowers who are up to date with payments, including mortgage prisoners to switch to new lenders. We will continue to work with industry on lenders being able to offer new switching options, based on our rule changes that introduced the modified affordability assessment, as soon as practicable.

9.6 We have also explored what else we can do to help borrowers who are unable to switch. We are consulting on a rule change on intra-group switching to remove potential barriers in our rules to closed book customers switching to a new mortgage with a firm that sits within the same group as their current closed book lender. In addition to this, we will continue our discussions with the Government, consumer groups and other stakeholders to explore other options for mortgage prisoners.

9.7 In the face of the coronavirus crisis, we have been looking to ensure that affected borrowers receive the necessary support. Our existing guidance on payment deferrals and repossessions applies to all borrowers, including mortgage prisoners. For borrowers with inactive firms who are not up to date with their mortgage payments or who are struggling financially with other debts. We are working with MaPS to create online information and a dedicated phone line for borrowers with inactive firms. Our new proposed guidance that we are also consulting on, is intended to help maturing interest-only and part-and-part borrowers and should benefit some mortgage prisoners alongside other borrowers affected by coronavirus.