FINANCIAL CONDUCT AUTHORITY

Mortgage customers: proposed changes to responsible lending rules and guidance

Consultation Paper

CP19/14***

March 2019

How to respond

We are asking for comments on this Consultation Paper (CP) by **26 June 2019**.

You can send them to us using the form on our website at: www.fca.org.uk/cp19-14-response-form

Or in writing to:
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1 Summary

Why we are consulting

1.1 We are concerned that some consumers cannot switch to a more affordable mortgage despite being up-to-date with their mortgage payments. This includes those who cannot switch because of changes to lending practices during and after the 2008 financial crisis and the subsequent regulation that tightened lending standards – so called 'mortgage prisoners'.

1.2 We consider that consumers who are in this position now, or who could be in this position in the future, are suffering harm, as they are paying higher than necessary mortgage payments. As we explained in our Mission, an important part of our role is that we act to identify harm, potential harm or markets not working as well as they could.

1.3 We have already said we will remove potential barriers in our rules that stop consumers switching to a more affordable mortgage. To do this we are consulting on changes to our responsible lending rules which will enable mortgage lenders to make more proportionate affordability assessments. This Consultation Paper (CP) sets out these proposals and asks for views.

1.4 Lenders will be allowed to use this assessment for consumers who are up-to-date with payments on their existing mortgage and who want to switch to a more affordable mortgage without borrowing more. As well as helping those consumers who may face barriers to switching under our current rules, these proposals will help reduce the time and cost of switching for all consumers meeting this definition.

Who this applies to

1.5 This consultation will be directly relevant to:

- mortgage lenders
- mortgage administrators
- mortgage intermediaries
- unregulated entities that own mortgage books
- mortgage customers

1.6 This consultation will also be relevant to stakeholders with an interest in the mortgage market, including:

- trade bodies representing mortgage firms
- charities and other organisations
- consumer organisations

The wider context of this consultation

1.7 Most mortgage products currently sold in the UK involve a short-term incentivised deal (any introductory, discount or fixed rate period) after which the rate changes to what is known as a 'reversion rate'. This usually means an increase in the interest rate and mortgage payments. At this point, it is usually in a consumer's interest to switch to a new mortgage product, either with their existing lender or a new lender, to minimise their mortgage payments.

1.8 If the market is working well, consumers can and do switch to minimise their mortgage payments. This behaviour can also lead to increased competition from firms and so benefits for all consumers. Overall, our Mortgages Market Study (MMS) found high levels of switching in the mortgage market. But it also found that some consumers face barriers to switching.

1.9 During and immediately after the 2008 financial crisis there was a major change to firms' lending practices. This change, and subsequent regulation to prevent a return to past poor practices, have left some consumers unable to find a new incentivised deal, despite being up-to-date with payments.

1.10 Additionally, market dynamics can change over time. Lenders can decide to reduce their exposure to credit risk if they are worried about some customers' ability to repay mortgages. A lack of available funding can also lead to lenders reducing their exposure to credit risk. These changes in lender risk appetite can mean some consumers, who are seen as higher risk, cannot find a new incentivised deal, again, despite being up-to-date with their payments.

1.11 In the MMS, we estimated that around 30,000 consumers would benefit from switching, but were unable to do so, despite being up-to-date with payments. Around 96% of these consumers took out their mortgage or last switched before the financial crisis. Of these, we estimate that around:

- 10,000 are with authorised firms that are actively lending ('active lenders')
- 20,000 are with authorised firms that are no longer actively lending ('inactive lenders')

1.12 We also identified a further 120,000 consumers whose mortgages are now owned by firms that are not authorised to lend ('unregulated entities') and who could potentially benefit from switching but may be unable to do so. We are particularly concerned about customers of both inactive lenders and unregulated entities, as they can only get a more affordable mortgage deal if they are able to switch to an active lender (see paragraphs 2.14-2.16).

1.13 As well as these groups affected by changes in lending practices and regulation after the financial crisis, we know there are others who may be unable to switch to a more affordable mortgage despite being up-to-date with their payments. This could be, for example, because their circumstances have changed since they took out their mortgage or last switched. It is also possible that certain consumers could find themselves in a similar situation in the future.

1.14 Finally, even if a consumer does not face any potential barrier to switching under our rules, there is a time and financial cost associated with having to undergo the affordability assessment in our current rules. By providing for a more proportionate affordability assessment, we consider that we can reduce the time and cost for consumers who want to switch.

What we want to change

1.15 We want to help remove potential barriers in our rules to consumers switching to a more affordable mortgage. So, we propose to amend our responsible lending rules and guidance so that:

- mortgage lenders can choose to carry out a modified affordability assessment ('modified assessment') where the consumer:
  - has a current mortgage
  - is up-to-date with their mortgage payments
  - does not want to borrow more, other than to finance any relevant product fee or arrangement fee for that mortgage
  - is looking to switch to a new mortgage deal on their current property
- inactive lenders, and administrators acting for unregulated entities, are required to review their customer books and contact relevant consumers. They must then write to them highlighting this rule change and directing them to relevant sources of information
- mortgage lenders that use the modified assessment are required to tell consumers the basis on which their affordability has been assessed and provide some additional disclosures about potential risks
- mortgage lenders are required to flag which sales have involved the modified assessment when they submit Product Sales Data (PSD) reports to us

Outcome we are seeking

1.16 We are proposing changes to our rules to help remove potential barriers to consumers who are up-to-date with payments being offered a more affordable mortgage. The aim is to help reduce the harm these consumers face from paying higher mortgage payments.

1.17 Our proposals will make it easier for customers of inactive lenders and unregulated entities to switch to an active, authorised lender.

1.18 While these proposals are intended to make it easier for firms to lend to these consumers, they do not require firms to do so. Firms can choose whether to apply the modified assessment. Lending is a commercial decision and we recognise that some of these consumers will have circumstances that are outside the risk appetite of many lenders. However, firms may wish to lend to some of these consumers, taking advantage of the flexibility proposed by these rule changes, and who would be able to switch to a more affordable mortgage.

1.19 As well as helping those consumers who may face barriers to switching under our current rules, these proposals are intended to help reduce the time and cost of switching for all consumers meeting the proposed definition.

Measuring success

1.20 We will measure the success of these proposals by the extent to which consumers who are up-to-date with payments and not looking to borrow more can switch to a more affordable mortgage under the modified assessment. This is dependent both on our proposed rule changes and on lenders willingness to apply the modified assessment. We propose to change our reporting requirements to help us monitor the numbers of consumers who switch based on the modified assessment.

Next steps

1.21 We want to know what you think about the proposals in this paper. Please send your comments to us by 26 June 2019 using one of the methods in the 'How to respond' section on page 2.

1.22 We will consider your feedback and publish rules in a Policy Statement in Q4 2019.

2 The wider context

The harm we are trying to address

2.1 We are concerned that some existing mortgage customers may be unable to switch to a more affordable mortgage that would reduce the cost of their borrowing. This can happen even if the consumer is up-to-date with payments on a mortgage with a higher monthly payment than they would pay if they switched. These consumers can experience financial harm through making mortgage payments that are higher than necessary.

2.2 Where consumers do not face barriers to switching, they still incur time and financial costs associated with having to undergo the affordability assessment in our current rules.

Our responsible lending rules

2.3 Between 2014 and 2016, our Mortgage Market Review (MMR) and our implementation of the Mortgage Credit Directive (MCD) resulted in significant changes to our regulatory requirements. This included revised responsible lending rules which were designed to prevent a return to the poor lending practices seen before the financial crisis. These rules aim to prevent consumers taking on mortgages they cannot afford, while not restricting access to mortgage finance for consumers who can demonstrate they can afford the loan. These rules require lenders to:

- assess affordability based on a borrower's verified income, credit and other contractual commitments, essential expenditure and basic quality of living costs (MCOB 11.6.2R, MCOB 11.6.8R to 11.6.13G)
- take into account known or likely future changes to income and expenditure (MCOB 11.6.14R)
- consider the effect of expected future interest rate rises (MCOB 11.6.18R)
- not assess affordability based on self-certified income (MCOB 11.6.8R) or house price inflation (MCOB 11.6.5R)
- only offer an interest-only mortgage if the customer has a credible repayment strategy (MCOB 11.6.41R)

2.4 This CP sets out proposals to keep that affordability assessment but modify it where the consumer is up-to-date with their payments and is not looking to borrow more.

2.5 Under our existing rules, lenders already have greater flexibility to help their existing customers switch to a new mortgage. Our rules do not require them to carry out an affordability assessment if a consumer is switching to a new deal with their existing lender and not borrowing more (see MCOB 11.6.3R and MCOB 11.7.1R). The proposals in this CP do not affect these existing rules.

2.6 Under our existing rules, lenders are also expected to consider the Financial Policy Committee (FPC)'s recommendation when taking account of likely future interest rate increases as part of the affordability assessment. This recommendation specifies that lenders should assess whether consumers could still afford their mortgage if, at any point during the first 5 years of the loan, their mortgage rate increased to 3% higher than the reversion rate at the time the mortgage is taken out.

2.7 The FPC has confirmed that the affordability recommendation does not apply to switching if there is no increase in the amount of borrowing, whether done by the same or a different lender.

Modifying our responsible lending rules

2.8 In 2016, we launched the MMS to review how the mortgage market is working and whether competition could be improved to bring greater consumer benefits. Key to this was a review of some aspects of the MMR, including the responsible lending requirements. In the MMS, we found that some consumers suffer harm because they cannot switch, despite being up-to-date with payments. Our proposals in this paper aim to address this harm by modifying our responsible lending rules.

2.9 We consider that a consumer with an existing mortgage who is up-to-date with payments should be able to afford a mortgage with a lower monthly payment. It is reasonable to reflect this in a more proportionate approach to responsible lending for consumers who are meeting their mortgage payments and not taking on any additional borrowing. In contrast, new borrowers, or those with an existing mortgage taking on additional borrowing, are potentially at greater risk of possible harm as they are taking on new or greater financial commitments.

The Mortgages Market Study

2.10 In the MMS Interim Report, we found that some consumers on a reversion rate would benefit from switching but were unable to do so, even though they were up-to-date with their mortgage payments. While the number of these consumers appears relatively small compared to both the entire population of mortgage holders and those currently on a reversion rate, the financial impact on these individuals can be significant.

2.11 To help this group of consumers who hold mortgages with active, authorised lenders, we proposed that lenders should commit to allowing their existing customers to switch to a cheaper deal where they:

- took out a mortgage or last switched before the lending criteria was tightened during and immediately post-crisis (ie before 2009)
- were up-to-date with payments, (and so demonstrating they can afford the mortgage at the current interest rate)
- did not want to borrow more

2.12 This proposal aimed to enable firms to treat these consumers in a similar way to consumers who could demonstrate affordability under the formal assessment criteria. It reflects the greater flexibility our current affordability rules give firms for consumers who are switching with their current lender (as outlined in paragraph 2.5).

2.13 Lender trade bodies responded to our interim report with a voluntary agreement, with 67 active lenders, reflecting around 97% of the market, committing to enabling borrowers on a reversion rate to move to a better deal, where they meet certain criteria. Examples of this criteria include being up-to-date with payments, and having a minimum of 2 years or £10,000 left on their mortgage. This agreement applied to all customers, not just those who took out or last switched a mortgage before the changes to lending practices during or immediately post-crisis.

Inactive lenders and unregulated entities

2.14 Inactive lenders are firms that, although still authorised to lend, are no longer lending on new products for new or existing customers. This includes firms administering their own portfolios of mortgages that are closed to new business (closed books).

2.15 Mortgage books can also be sold to 'unregulated entities', ie firms that are not authorised to conduct mortgage business, although the administration of these accounts must be carried out by a regulated firm. Some of the closed books sold like this came from the sale of failed lenders' mortgage books after the 2008 financial crisis.

2.16 Since these firms are either no longer actively lending or do not have FCA permission to enter into new mortgage contracts, mortgage consumers in these books can only switch if they move to another lender. But to do so, they need to pass an affordability assessment and meet the lending criteria of an active lender.

The role of industry

2.17 Following our publication of the MMS Interim Report, we convened an industry working group of lender trade bodies. We asked this group to consider:

- the commercial, regulatory or other barriers to possible solutions for customers of inactive lenders and unregulated entities
- how these barriers could be reduced
- the role of the FCA, active lenders, the Government and other stakeholders in overcoming any barriers to provide potential solutions
- the reasons some consumers cannot switch in the open market

2.18 The picture is not the same for all consumers who cannot switch. A key reason that some may not be able to switch is that their specific circumstances tend to make them too high risk for lenders. This could include consumers who:

- are in arrears
- have very high loan-to-value mortgages
- have other considerable debts
- have mortgages in negative equity

2.19 We do not have the power to help consumers who cannot switch because they do not meet lenders' commercial risk appetite. Lending remains a commercial decision. But the working group agreed there are likely to be some consumers with mortgages held by inactive lenders or unregulated entities, who may be within the risk appetite of active lenders, but who would not pass an affordability assessment under our current rules.

2.20 While the working group focused on solutions for customers of inactive lenders and unregulated entities, we have used its conclusions in developing our overall policy proposals in this CP.

How our proposals link to our objectives

Consumer protection

2.21 Consumers who cannot switch to a cheaper mortgage, despite being up-to-date with payments, suffer harm by paying more than necessary. By reducing barriers to a consumer switching to a mortgage product with a new lender, we hope to reduce the financial impact of higher mortgage payments on these consumers.

Competition

2.22 Where the mortgage market works well, consumers can and do switch to minimise their mortgage payments. This behaviour can drive competition amongst lenders to offer attractive rates which benefit all consumers. The MMS found the mortgage market is largely working in the variety of products on offer, as well as with competition on headline rates between lenders. However, it also found a minority of consumers who cannot switch to a more affordable mortgage.

2.23 Reducing regulatory barriers to consumers switching their mortgage to a new lender should help drive competition and benefit all consumers.

Wider effects of this consultation

2.24 Annex 3 sets out our analysis of benefits and costs to firms and consumers from our proposals.

Equality and diversity considerations

2.25 We have considered the equality and diversity issues that may arise from the proposals in this CP. Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when making the final rules.

2.26 In the meantime, we welcome your input to this consultation.

3 Changes to our responsible lending rules

3.1 In this Chapter, we set out our proposals to change our responsible lending rules and guidance to allow firms to make modified assessments for consumers who are up-to-date with payments on their existing mortgage and want to switch to a more affordable mortgage without borrowing more.

Which consumers these changes apply to

3.2 We propose to limit our proposed new rules and guidance so that they will only apply to eligible consumers. We propose that eligible consumers must:

- have a current mortgage
- be up-to-date with their mortgage payments
- not want to borrow more, other than to finance any relevant product fee or arrangement fee for that mortgage
- be looking to switch to a new mortgage deal on their current property

3.3 It is important that the consumer can demonstrate that they have been up-to-date with payments (ie not in payment shortfall) both when they apply for the new mortgage and over the previous 12 months. A snapshot may hide a consumer's historic late payments or previous forbearance by lenders, which could create doubt about their ability to meet future commitments. This part of the eligibility test will ensure a consumer has demonstrated that they have kept up their mortgage payments over a significant recent period. This gives an indication of their likely ability to make future, and lower, payments under a more affordable mortgage.

3.4 We are also interested in views on whether there are circumstances where this definition could be unnecessarily burdensome.

Q1: Do you agree that our proposals should only apply to firms dealing with consumers that meet the conditions of 'eligible consumers'?

Q2: Do you agree that 'up-to-date with payments' should be decided by not being in payment shortfall, both at the time of application and over the previous 12 months?

The modified affordability assessment

3.5 Under our current rules, a firm must not enter into a mortgage contract unless it has determined that the consumer can afford the mortgage (MCOB 11.6.2R).

3.6 We propose to allow lenders to operate a modified assessment for eligible consumers, if the lender wants to do so. Under this modified assessment, mortgage lenders must not enter into a new regulated mortgage contract with an eligible consumer unless they can demonstrate that the new mortgage is more affordable than their present one.

3.7 We also intend to allow mortgage lenders that choose to use the modified assessment to disapply (no longer apply) certain of our existing rules. This is set out in paragraphs 3.26 to 3.39 below.

A more affordable mortgage

3.8 Our proposed definition of a 'more affordable' mortgage differs depending on whether any product and arrangement fees have been added to the mortgage or whether the consumer is paying them upfront. Where the consumer pays a relatively large fee upfront, this can add significantly to the total cost of their mortgage in the short term without being reflected in the monthly payment. It is important that firms consider this when they assess affordability.

3.9 Where product or arrangement fees have been added to the mortgage, our proposed definition of a 'more affordable' mortgage requires that the

- new mortgage must have a lower interest rate during the incentivised deal period (or, if there is no such period, across the whole mortgage term) than the interest rate the consumer is currently paying on their existing mortgage
- monthly payments due under the new mortgage in the incentivised deal period (or, if there is no such period, across the whole mortgage term) are no higher than those due under the existing mortgage

3.10 The proposed definition includes both lower monthly payments and a lower interest rate. Lower monthly payments are essential as the assessment is based on the consumer having demonstrated their ability to meet higher monthly payments (over 12 months). Without including a lower interest rate, a consumer's mortgage term could, where there is no deal period, be extended to ensure lower monthly payments but the lender could still charge a higher interest rate. This would leave the consumer paying significantly more for their mortgage overall.

3.11 Where product or arrangement fees are added to the mortgage and repaid across the full term, some consumers could pay more overall. This is because they will have to pay interest on those fees (as part of the capital outstanding on their mortgage) during the full term of the mortgage. However, these consumers may want to pay a lower rate in the shorter term and we do not want to exclude them from being eligible for the modified assessment if they cannot afford to pay these fees upfront.

3.12 We have considered whether firms need to make an additional disclosure to tell these consumers that they could pay more over the full mortgage term in these circumstances. But we have decided it is unnecessary. We already have a rule that requires firms not to add fees to the mortgage unless the consumer has chosen this option.

3.13 Where the consumer is paying product or arrangement fees upfront and they are not being added to the mortgage, our proposed definition of a 'more affordable' mortgage requires that the

- total expected cost of the new mortgage over the incentivised deal period (or, if there is no such period, across the whole mortgage term), including the fees paid

upfront, is less than the consumer would have paid on their existing mortgage over that time
- new mortgage must have a lower interest rate during the incentivised deal period (or, if there is no such period, across the whole mortgage term) than the interest rate the consumer is currently paying on their existing mortgage

3.14 To help illustrate the proposed definitions, we have provided worked examples in Annex 1.

3.15 We would like respondents' views on adding another condition to our proposed definitions of 'more affordable' that refers to the existing reversion rate of the new lender. Under this definition, both the interest rate of the new mortgage during any incentivised period and the new lender's reversion rate must be no higher than the rate the consumer is currently paying on their existing mortgage. Or, if they are still in an incentivised period, the reversion rate they will pay at the end of that period.

3.16 We would implement that requirement by an addition to the proposed MCOB 11.9.5R (in Appendix 1) which would read: 'the interest rate which would apply to the proposed regulated mortgage contract after any discounted or introductory period is no higher than:

- the interest rate currently being applied to the existing regulated mortgage contract, and
- where the existing regulated mortgage contract is still in a discounted or introductory period, the interest rate which would be applied to that contract after any discounted or introductory period.'

3.17 We recognise that this could make the new rules unavailable to certain smaller or specialist firms. We would welcome views from respondents on this trade off.

3.18 We expect that most eligible consumers looking to switch to a new incentivised deal will be on a reversion rate. We have considered whether to restrict the revised affordability assessment to consumers on a reversion rate. However, we do not think this is necessary. The same principle of relative affordability should apply to someone moving from a fixed rate mortgage to another fixed rate, or a fixed rate to a variable one. If we did restrict the rule to consumers on a reversion rate, then a consumer would be forced to wait until they were on a reversion rate to switch. This would simply add a delay for consumers and not improve outcomes. There are also products that do not revert to a variable reversion rate (eg lifetime trackers). Consumers on these mortgage deals would not be eligible if we restricted this rule to consumers on a reversion rate.

3.19 A mortgage can also be made more affordable on a monthly basis by extending its term. This may be attractive in the short term, but will probably lead to the consumer paying more overall. We do not think it is necessary to ban this. Term extensions happen regularly in the market, and they can reduce monthly payments. A consumer should be aware that the effect of extending the term of the mortgage is that they may pay more interest overall, and we propose to require lenders to make this clear to consumers (see paragraphs 4.9 and 4.10). Additionally, if the new extended term would take the consumer past their anticipated retirement age, we propose to introduce a rule that lenders should consider income in retirement.

Q3: Do you agree with our approach to defining a 'more affordable' mortgage, both where product or arrangement fees have been added to the mortgage and where they have not?

Q4: What are your views on a definition of 'more affordable' that refers to both the interest rate during any incentivised deal period and the new lender's existing reversion rate at the time?

Q5: Do you agree that we should allow lenders to extend the term of the mortgage when they undertake the modified assessment?

3.20 Whenever we consider changes to our rules, we assess the risk of potential consumer harm. We are particularly aware of the risk that a consumer could switch to a cheaper deal but end up on a higher reversion rate than they would otherwise have been on, or which they cannot afford. Our proposals allow a borrower to switch again, but it is possible that another lender may not take them on.

3.21 The industry agreement set out in paragraph 2.13 is important in managing this risk. As long as the consumer's mortgage is held by an active lender that has signed up to the agreement, and they remain up-to-date with payments, they should be eligible for a better deal at the end of the incentivised period.

3.22 However, not all active lenders have signed up to the industry agreement. So we propose to restrict the use of the modified assessment to those active lenders that have in place, and operate, a policy for offering their existing customers the ability to switch to a more affordable mortgage product.

Q6: Do you agree with our proposal to only allow lenders to use the modified affordability assessment if they have a policy allowing consumers to switch to a more affordable mortgage?

3.23 Despite a consumer being on a lower rate than their previous mortgage, they could still go into payment shortfall, for example, because their circumstances change. Where this occurs, the modified assessment would no longer be available to them.

3.24 Our rules in MCOB 13 set out how we expect firms to treat consumers in payment shortfall or arrears fairly. These rules include requirements for firms to make reasonable efforts to agree with the consumer how that shortfall can be cleared, and considering forbearance options given the consumer's individual circumstances.

3.25 In Chapter 4 we set out proposals for lenders undertaking the modified assessment to tell consumers the basis on which their affordability has been assessed and provide some additional disclosures about potential risks.

How the new rules affect current MCOB rules

3.26 Where a lender chooses to use the new modified affordability assessment, we propose to allow them to disapply the following rules:

- MCOB 11.6.2R to 11.6.4R (assessment of affordability) would be disapplied in favour of the new modified affordability assessment
- MCOB 11.6.5R to 11.6.13G (income and expenditure)
- MCOB 11.6.14R to 11.6.15G (future changes to income and expenditure)
- MCOB 11.6.18R to 11.6.19G (considering the effect of future interest rate rises)
- MCOB 11.6.40G to 11.6.48R and MCOB 11.6.50R and 11.6.52G (interest-only mortgages)

3.27 We also propose new rules and guidance for lenders to follow when they undertake the modified assessment. These are set out below.

Income and expenditure

3.28 We propose to allow lenders that choose to use the modified assessment to disapply our rules which require lenders to verify the consumer's income and specify what they should consider when assessing the consumer's committed and basic essential expenditure (MCOB 11.6.5R to 11.6.13G).

3.29 We recognise that many lenders that adopt our proposed modified assessment may still choose to consider a consumer's income and expenditure. Where they do, we propose guidance that the lender can take into account that the consumer is up-to-date with payments and moving to a more affordable mortgage when deciding how intensive an investigation of the consumer's income, expenditure and other financial circumstances to undertake.

Future changes to income and expenditure

3.30 We propose to allow lenders that choose to use the modified assessment to disapply our rules which require lenders to take into account likely future changes in the consumer's income and expenditure during the term of the mortgage (MCOB 11.6.5R to 11.6.15G).

3.31 However, where the new mortgage would extend into retirement, we are proposing a new rule. This would require lenders to consider whether the consumer's income after retirement would be enough for them to meet their commitments under the contract. We also propose guidance that lenders should take a prudent and proportionate approach to assessing the consumer's income in retirement. A consumer's retirement income could have a significant impact on whether they can continue making mortgage payments.

Q7: **Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our income and expenditure rules (MCOB 11.6.5R to 11.6.15G)?**

Q8: **Do you agree that we should require lenders to consider whether the consumer's income after retirement would be enough to enable them to meet their commitments under the contract?**

Interest rate stress test

3.32 As set out in Chapter 2, the FPC has confirmed that its interest rate stress recommendation does not apply to any switching if there is no increase in the amount borrowed, whether done by the same or a different lender.

3.33 Our rules (MCOB 11.6.18R to 11.6.19G) currently require lenders to consider the effect of future interest rate rises as part of their affordability assessments. This includes having regard to market expectations and assuming that interest rates will rise by a minimum of 1% over the first 5 years of the regulated mortgage contract.

3.34 We propose to allow lenders that choose to use the modified assessment to disapply this interest rate stress test requirement. We also propose guidance that, where lenders do choose to undertake some form of stress test, they may want to bear in mind that the consumer is currently meeting payments at a higher rate on their existing mortgage than on the more affordable mortgage. Consumers will be moving onto a more affordable mortgage and the headroom created by the move should provide some buffer against future interest rate increases.

> **Q9:** **Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our interest rate stress test rules (MCOB 11.6.18R to 11.6.19G)?**

> **Q10:** **Do you agree that we should introduce guidance that, if considering future interest rate rises, lenders may wish to take into account the fact that the consumer is currently meeting payments at a higher rate than on the more affordable mortgage?**

Interest-only mortgages

3.35 We propose to allow lenders that choose to use the modified assessment to disapply our rules and guidance on interest-only mortgages (MCOB 11.6.40G to 11.6.48R and MCOB 11.6.50R to 11.6.52G). This includes the requirement for the consumer to have a credible repayment strategy in place.

3.36 A consumer who does not have a credible repayment strategy in place is already at risk of harm. We do not think this should disqualify them from getting a more affordable mortgage. And for customers of inactive lenders or unregulated entities, an active lender will have more options to support maturing interest-only customers in the future.

3.37 It would clearly be inappropriate for anyone to take on new interest-only borrowing if they do not have a credible repayment strategy in place. Our existing rules and guidance on interest-only mortgages would still apply where

- consumers want to increase the proportion of the loan on an interest-only basis (where it is a part interest-only and part capital repayment mortgage) or
- they are looking to move from a capital repayment mortgage to an interest-only mortgage.

3.38 This will reduce the potential for future consumer harm by not allowing further interest-only borrowing without a credible repayment strategy.

3.39 Lenders will still be required to review any interest-only mortgages and contact the customer at least once during the term of the mortgage. Where a consumer does not have a credible repayment strategy in place, this will ensure that the lender is still required to prompt a conversation with the customer to help them find a repayment strategy if possible.

> **Q11: Do you agree that we should allow lenders that choose to use the modified assessment to disapply MCOB 11.6.40G to 11.6.48R and MCOB 11.6.50R to 11.6.52G as long as the consumer is not trying to increase the proportion of the loan on an interest-only basis?**

Home movers

3.40 The proposals in this CP apply to consumers who are looking to switch to a new mortgage deal on their current property. We are also interested in the views of respondents on whether the modified assessment should be available to consumers who are looking to switch to a new mortgage deal on a different property (eg those downsizing). Providing the other conditions of the modified assessment (as set out in paragraphs 3.2 to 3.4) are met, there is a good case that the same treatment should be available.

3.41 Such a rule would mean the removal of the current requirement in MCOB 11.9.1R(2)(b) in the draft rule instrument that the new mortgage must be on the same property.

3.42 We are mindful that there are differences, however. Moving property is likely to be correlated with other changes that might make an affordability assessment that considers income and expenditure more appropriate, such as change in living expenses (eg travel costs, council tax) and moving costs. It is also important to note that the FPC's guidance on the exclusion of remortgagors from its stress test recommendation (outlined in paragraphs 2.6 and 2.7) does not currently extend to home movers looking to switch to a new lender. We would therefore propose to share any responses on this point with the FPC to inform its policy making prior to us making final rules.

> **Q12: Do you have views on whether the modified assessment should be available for home movers looking to switch to a new lender?**

4 Changes to other rules and guidance

4.1 In this chapter, we set out our proposals to

- amend our rules and guidance to ensure that specific consumers are told about these changes and know where to find further information about how they could switch to a more affordable mortgage
- require a lender that undertakes a modified assessment to make additional disclosures
- make minor changes to our Product Sales Data (PSD) reporting for lenders using the new modified assessment

Consumer communications requirements

4.2 Our proposals for a modified assessment are intended to enable any existing borrower to switch to a more affordable mortgage more easily.

4.3 However, as we explain in this CP, we are particularly concerned that customers of inactive lenders and unregulated entities are told about these changes, as they do not have the option to switch products with their existing lender.

4.4 We are working with both lender and intermediary trade bodies on a communication strategy to agree potential ways to give these consumers this information. As part of this, our view is that inactive lenders and administrators acting for unregulated entities should be required to contact relevant customers and give them the information. This should outline the changes in our rules in this CP, highlight that they may be able to switch to a new mortgage deal with a new lender, and direct them to further information.

4.5 We recognise that contacting all customers could be disproportionate for these firms. It could also raise customers' expectations, including those who are unlikely to be able to benefit from the modified assessment. So we propose that administrators of unregulated entities and inactive lenders should review their books and only contact customers who:

- have residential mortgages that are not lifetime mortgages
- are up-to-date with payments and have been for 12 months
- are currently on a reversion rate

4.6 We propose some standard wording in our rules to explain what the effect of the rules is. But we also want customers to be informed about where they can go to find out more. We want to work with industry to tailor this aspect of the customer communications further, as we have done successfully in other areas, such as customers with a maturing interest-only mortgage. So, we propose only a high-level requirement in the rules to refer the customer to sources of information. We will continue to work with industry to develop both what those sources are and how customers can be referred to them.

4.7 We propose that this communication is a one-off requirement which administrators and inactive lenders will have to send within 13 months of the introduction of the new rules. We do not think it is proportionate to require these firms to continue contacting these customers on an ongoing basis.

4.8 There is a risk that some consumers that get the communication may not be able to find a lender willing to offer them a new mortgage deal and could face costs trying to do so. We are exploring if we can reduce this risk by developing a triaging approach with the industry. This would help ensure that consumers who are unlikely to get a new deal are told as early as possible in the process.

Q13: Do you agree that we should require inactive lenders and administrators acting for unregulated entities to contact their customers and make them aware that our rules mean they may be able to switch to a new mortgage product with a new lender?

Q14: Do you agree that administrators and inactive lenders should only contact customers that have a residential mortgage, that is not a lifetime mortgage, and who are up-to-date with payments and on a reversion rate?

Additional disclosure

4.9 It is important that any consumer who switches under the proposed modified assessment is aware of the potential risks of this. So we propose that the new lender should provide them with an additional disclosure that sets out:

- what steps the lender has taken to determine whether the new mortgage is more affordable than the existing mortgage, and how those steps differ from the lender's standard approach to assessing affordability
- that there is a risk the consumer could end up on a higher reversion rate than their current mortgage rate
- the assessment of whether the new mortgage is more affordable for the consumer has not included any early repayment charges they may have to pay to leave their current mortgage
- if the new mortgage will terminate later than the current one, that the consumer may end up paying more interest overall

4.10 The lender of the new mortgage would provide this disclosure to consumers no later than the mortgage offer document.

Q15: Do you agree we should require lenders to give this disclosure?

Regulatory reporting

4.11 We want to collect information on lenders' use of the modified assessment so we can understand how they are using them in practice to help consumers switch to a new deal. This will allow us to match these data with the later performance of the mortgage through our Product Sales Data (PSD) and assess whether consumer outcomes have been improved. We propose to add a new data reporting field, in which lenders will record where they have sold a mortgage to a consumer using the proposed rules.

4.12 We also propose to add two flags to that reporting field to indicate whether or not the mortgage is expected to extend into retirement. This will allow us to monitor whether lenders are complying with our proposed rule requiring them to consider income in retirement should a term extension take the consumer past their anticipated retirement age.

4.13 We also propose to amend our Supervision manual (SUP) to state that, where lenders have sold a mortgage to a consumer using the modified assessment, they are not required to report the affordability data required in PSD. This reflects the fact that, while firms may collect some of this information, they will no longer be required to collect all of it to undertake the modified affordability assessment. Where a lender is expecting to lend into retirement, they will still be required to report the expected retirement age through PSD.

Q16: **Do you agree we should require lenders to report data on use of the modified affordability assessment?**

Q17: **Do you agree that we should amend SUP to state that, where lenders have sold a mortgage using the modified assessment, they are not required to report the affordability data required in PSD**

Annex 1
Worked examples of the modified affordability assessment

1. The worked example below gives examples of an affordable and two unaffordable mortgages in the case where product or arrangement fees have been added to the mortgage

More affordable:

a. The customer is on a 25-year mortgage with £200,000 outstanding and 20 years of the term left to run. The customer is on a reversion rate of 5% and paying monthly payments of £1,320. The customer wants to move to a mortgage with a 2.99% fixed rate deal for 27 months (that then goes onto a reversion rate of 4.99%). This new deal has a product fee of £995 that is added to the mortgage. This would mean they would be paying £1,114 per month in the deal period. This new mortgage would be considered more affordable than the current mortgage as:

- the interest rate on the current mortgage (5%) is higher than the interest rate in the deal period of the new mortgage (2.99%)
- the monthly payment on the current mortgage (£1,320) is higher than the monthly payment in the deal period of the new mortgage (£1,114)

Not more affordable:

b. The customer is on a 25-year mortgage with £200,000 outstanding and 20 years of the term left to run. The customer is on a reversion rate of 3.69% and paying monthly payments of £1,179. The customer wants to move to a mortgage with a 4.79% fixed rate deal for 24 months (that goes onto an standard variable rate (SVR) of 5%) with no product or application fee. This would mean they would be paying £1,297 in the deal period. This new mortgage would not be considered more affordable than the current mortgage as:

- the interest rate on the current mortgage (3.69%) is lower than the interest rate in the deal period of the new mortgage (4.79%) and
- the monthly payment on the current mortgage (£1,179) is lower than the monthly payment in the deal period of the new mortgage (£1,297)

c. The customer is on a 25-year mortgage with £200,000 outstanding and 20 years of the term left to run. The customer is on a fixed rate of 4.5% (that goes onto a SVR of 5%) paying monthly payments of £1,265. The customer wants to move to a lifetime tracker mortgage with a fixed rate of 5.5% with a £500 product fee. This would mean they would be paying £1,379 per month. This new mortgage would not be considered more affordable than the current mortgage as:

- the interest rate on the current mortgage (4.5%) is lower than the interest rate of the new mortgage (5.5%)
- the monthly payment on the current mortgage (£1,265) is lower than the monthly payment of the new mortgage (£1,379)

2. The worked example below gives examples of an affordable and two unaffordable mortgages where product or arrangement fees are being paid upfront and are not being added to the mortgage.

A more affordable mortgage:

a. The customer is on a 25-year mortgage with £200,000 outstanding and 20 years of the term left to run. The customer is on a reversion rate of 5% and paying monthly payments of £1,320. The customer wants to move to a mortgage with a 2.99% fixed rate deal for 27 months (that goes onto an SVR of 4.99%). This new deal has a product fee of £995 that is paid up front. This would mean they would be paying £1,108 in the deal period. This new mortgage would be considered more affordable than the current mortgage as:

- the total expected cost of the new mortgage over the deal period (£30,911, being £1,108 per month x 27 months plus £995 fees) is lower than the total cost of the current mortgage over that period (£35,640, being £1,320 per month x 27 months)
- the interest rate on the current mortgage (5%) is higher than the interest rate in the deal period of the new mortgage (2.99%)

Not more affordable:

b. The customer is on a 25-year mortgage with £200,000 outstanding and 20 years of the term left to run. The customer is on a reversion rate of 3.69% and paying monthly payments of £1,180. The customer wants to move to a mortgage with an 4.79% fixed rate deal for 24 months (that goes onto an SVR of 5%) with a £199 application fee which is paid upfront. This would mean they would be paying £1,297 in the deal period. This new mortgage would not be considered more affordable than the current mortgage as:

- the total expected cost of the new mortgage over the deal period (£31,327, being £1,297 x 24 months plus the £199 fee) is higher than the total cost of the current mortgage over this same period (£28,320, being £1,180 per month x 24 months)
- the interest rate on the current mortgage (3.69%) is lower than the interest rate of the new mortgage (4.79%)

c. The customer is on a 25-year mortgage with £200,000 outstanding and 20 years of the term left to run. The customer is on a reversion rate of 4% and paying monthly payments of £1,212. The customer wants to move to a mortgage with a 3.5% fixed rate for 20 months (that goes onto an SVR of 3.99%). This new deal has a product fee of £2,000 that is paid up front. This would mean they would be paying £1,160 in the deal period. This new mortgage would not be considered more affordable than the current mortgage as:

- the interest rate on the current mortgage (4%) is higher than the interest rate of the new mortgage (3.5%)
- the total expected cost of the new mortgage over the deal period (£25,200 being £1,160 per month x 20 months plus £2,000 fees) is higher than the total cost of the current mortgage over that period (£24,240, being £1,212 per month x 20 months)

Annex 2
Questions in this paper

Q1: **Do you agree that our proposals should only apply to firms dealing with consumers that meet the conditions of 'eligible consumers'?**

Q2: **Do you agree that 'up-to-date with payments' should be decided by not being in payment shortfall, both at the time of application and over the previous 12 months?**

Q3: **Do you agree with our approach to defining a 'more affordable' mortgage, both where product or arrangement fees have been added to the mortgage and where they have not?**

Q4: **What are your views on a definition of 'more affordable' that refers to both the interest rate during any incentivised deal period and the new lender's existing reversion rate at the time?**

Q5: **Do you agree that we should allow lenders to extend the term of the mortgage when they undertake the modified assessment?**

Q6: **Do you agree with our proposal to only allow lenders to use the modified affordability assessment if they have a policy allowing consumers to switch to a more affordable mortgage?**

Q7: **Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our income and expenditure rules (MCOB 11.6.5R to 11.6.15G)?**

Q8: **Do you agree that we should require lenders to consider whether the consumer's income after retirement would be enough to enable them to meet their commitments under the contract?**

Q9: **Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our interest rate stress test rules (MCOB 11.6.18R to 11.6.19G)?**

Q10: **Do you agree that we should introduce guidance that, if considering future interest rate rises, lenders may wish to take into account the fact that the consumer is currently meeting payments at a higher rate than on the more affordable mortgage?**

Q11: **Do you agree that we should allow lenders that choose to use the modified assessment to disapply MCOB 11.6.40G to 11.6.48R and MCOB 11.6.50R to 11.6.52G as long as the consumer is not trying to increase the proportion of the loan on an interest-only basis?**

Q12: **Do you have views on whether the modified assessment should be available for home movers looking to switch to a new lender?**

Q13: **Do you agree that we should require inactive lenders and administrators acting for unregulated entities to contact their customers and make them aware that our rules mean they may be able to switch to a new mortgage product with a new lender?**

Q14: **Do you agree that administrators and inactive lenders should only contact customers that have a residential mortgage, that is not a lifetime mortgage, and who are up-to-date with payments and on a reversion rate?**

Q15: **Do you agree we should require lenders to give this disclosure?**

Q16: **Do you agree we should require lenders to report data on use of the modified affordability assessment?**

Q17: **Do you agree that we should amend SUP to state that, where lenders have sold a mortgage using the modified assessment, they are not required to report the affordability data required in PSD**

Annex 3
Cost benefit analysis

Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made and an estimate of those costs and of those benefits'. Section 138I also provides that if, in our opinion, the costs or benefits cannot reasonably be estimated or it is not reasonably practicable to produce an estimate, the CBA need not estimate them; in that case, the CBA must include a statement of our opinion and an explanation of it.

2. This CBA presents our analysis of the impacts of our proposed changes to our responsible lending rules and guidance on mortgages. We provide monetary values for the impacts where we believe we can reasonably estimate them and it is reasonably practicable to do so.

3. The CBA has the following sections:

- Problem and rationale for intervention
- Our intervention
- Baseline and key assumptions
- Summary of costs and benefits
- Benefits
- Costs
- Impact on intermediaries

Problem and rationale for intervention

4. There are two areas of harm that we are seeking to remedy with our proposals. First, the harm arising where our affordability rules contribute to preventing consumers switching to a more affordable mortgage. This harm is experienced by so-called 'mortgage prisoners'. Second, the harm arising from the costs of applying our current affordability rules to consumers who want to switch to a more affordable mortgage without borrowing more.

5. There are some additional areas of harm that our proposals address.

Consumers paying too high rates of interest

6. Our Mortgages Market Study found that most consumers who take out mortgages with short-term introductory rates switch when the mortgage changes to a reversion rate. However, a minority of consumers cannot switch as a result of lending decisions based on assessments of affordability, and this leads them to paying higher than necessary mortgage repayments. The affordability assessment indicates they are unable to afford the new mortgage even though they have been paying higher repayments on their existing mortgage, potentially for many years.

7. We do not think all of those consumers who are suffering or may suffer harm can be assisted by the proposals set out in this CP. Some consumers who are paying relatively high rates of interest may not meet our definition of harm if in practice they could not get a more affordable mortgage from another provider. This could be the case if they are considered particularly high-risk and therefore not profitable at an interest rate below their existing rate.

8. There are three categories of consumer who potentially cannot switch and who could potentially benefit from our proposals:

- Consumers with mortgages held by active mortgage lenders.
- Consumers with mortgages held by inactive mortgage lenders.
- Consumers with mortgages held by unregulated entities.

Consumers with mortgages held by active mortgage lenders

9. Analysis undertaken for the Mortgages Market Study, using data from 2016, estimated there were around 30,000 consumers on the mortgage books of firms authorised for lending who would have benefited from switching but appeared unable to do so, despite being up to date with payments. These 30,000 consumers include some 10,000 customers of active, authorised lenders.

10. We do not think there are many customers of active lenders who are suffering harm as a result of potential barriers in our rules. This is because our rules do not require an affordability assessment where a consumer is switching to a new deal with their existing lender and not borrowing more. Many lenders tell us they do not carry out any new credit or affordability assessments on existing customers applying to switch to a new mortgage deal internally.

11. Where firms do carry out these assessments, their customers will be helped by the cross-industry voluntary agreement (announced in July 2018). This voluntary agreement aims to help existing borrowers on reversion rates who are up-to-date with repayments but, because of stricter eligibility criteria, are currently unable to move to an alternative product provided by their lender. Our proposals may provide additional help to consumers with active, authorised lenders, even if the lender has signed up to the industry voluntary agreement, as they may give them options to switch to other lenders.

12. There are a small number of lenders (making up around 5% of the mortgage market), which have not signed up to the voluntary agreement whose mortgage customers may be suffering harm. Customers of these firms would potentially be helped by our proposals.

Consumers with mortgages held by inactive mortgage lenders

13. There are around 20,000 customers of firms that are no longer lending commercially despite being authorised to do so (inactive lenders). Some of these consumers will be prevented from switching to other lenders as a result of potential barriers in our rules.

Consumers with mortgages at unregulated mortgage lenders

14. There are around 120,000 consumers that could potentially benefit from switching with mortgages that have been sold to firms not authorised for lending. This can arise, for example, if a lender's business model involves originating mortgages and selling them to investors. Some of these closed books resulted from the sale of the assets (ie mortgage books) following the 2008 financial crisis.

The costs of undertaking affordability assessments

15. Our rules require firms to assess affordability before entering into a regulated mortgage contract. The intention of these rules is to prevent consumers taking on mortgages which are

unaffordable, while not restricting access to mortgage finance for consumers who can demonstrate that they can afford the loan. Our rules apply to all new mortgage contracts, including where consumers are not taking on additional borrowing.

16. These assessments increase costs for consumers who are switching but do not lower the costs arising from unaffordable mortgages. Consumers can be expected to switch mortgage when there is a lower cost to their borrowing, or to gain payment certainty on a fixed rate, taking in to account all the costs of switching. Given the lower cost, the mortgage switched to could be expected to be more affordable. As a result, rules which may be preventing consumers from moving to cheaper deals will not lead to unaffordable mortgages being avoided. Rather, they have the opposite effect by leaving consumers paying more in interest payments.

17. We estimate that there are around 150,000-250,000 consumers per year that switch to a new mortgage deal a new lender without taking on any further borrowing.

18. We are also considering extending our proposals to those consumers who move to a new property without borrowing more. We are unable to identify these consumers from the data we have. Including these consumers in our estimate of the consumers that undertake potentially unnecessary affordability assessments would increase our range of 150,000-250,000.

19. Affordability assessments are not costless. Oxera, in 2010, estimated the costs of the affordability rules was £11.50 per mortgage application. Taking into account inflation, this implies that the cost will be around £13 per transaction. There was, however, considerable uncertainty about the costs arising from affordability assessments at the time, and we believe that there is likely to be a wide variance in the costs of undertaking assessments. These costs are borne by providers but we would expect most of these costs to be passed through to consumers in the form of higher prices.

Increased probability of default from higher interest rates

20. Consumers who are paying higher rates of interest than necessary will be at greater risk of missing payments or otherwise defaulting on the terms of the mortgage contract. Lower interest payments generally make it easier for consumers to meet their payments.

21. A consumer entering into arrears and default is not costless. There are significant costs for firms, consumers and organisations supporting consumers with debt from arrears, default and repossession.

22. The work on the Mortgage Market Review provides some insight in to the costs of arrears and repossession. While somewhat out of date (and reduced by some of the changes made in CP 10/16), it provides a broad estimate of the costs of arrears and repossession. Oxera found that the costs of arrears were £375 per case and the costs of repossession were £27,000 per case. These costs are typically incurred by the lender but will likely passed on to the consumer through fees and charges. These illustrate the additional potential costs of consumers paying higher interest rates if it causes them to enter arrears or default.

23. Less than 1% of mortgage balances are in arrears. We note that the UK has historically low levels of repossession and therefore the short-term harm is likely to be quite limited. If arrears and repossessions increase, we might expect those consumers who currently cannot switch would be most at risk and therefore the level of harm suffered may be greater in the future.

Lack of competition in the supply of mortgages to consumers who cannot switch

24. The inability of consumers to switch to a new lender may lead to the administration and management of mortgage books with significant numbers of these customers being run less efficiently than in the wider market. This is because closed books do not have the same competitive pressure to ensure that they are as efficient as possible. This may be especially true of internally run inactive lenders rather than firms who contract out the administration of their mortgage books. Although firms are incentivised to use a competitive process to maximise profits, we would expect that the limited competition could result in some inefficiencies remaining.

The drivers of harm

Regulation prevents consumers from switching

25. The key driver of harm is lending decisions, based (at least in part) on affordability assessment requirements, preventing existing borrowers that are up-to-date with their payments from moving to a more affordable mortgage. Our rules require an affordability assessment to be carried for all new mortgage contracts. But we consider a more proportionate assessment is appropriate where consumers with an existing mortgage are seeking to move to a more affordable mortgage without taking on additional borrowing.

Our intervention

26. We are proposing to amend our responsible lending rules and guidance so that:

- mortgage lenders can choose to carry out a modified affordability assessment where the consumer:
  - has a current mortgage
  - is up-to-date with their mortgage payments
  - does not want to borrow more, other than to finance any relevant product fee or arrangement fee for that mortgage
  - is looking to switch to a new mortgage deal on their current property
- inactive lenders, and administrators acting for unregulated entities, are required to review their customer books and contact relevant consumers. They must then write to them highlighting this rule change and directing them to relevant sources of information.
- mortgage lenders that use the modified assessment are required to tell consumers the basis on which their affordability has been assessed and provide some additional disclosures about potential risks
- mortgage lenders are required to flag which sales have involved the modified assessment when they submit Product Sales Data (PSD) reports to us.

27. The following figure shows the causal chain for the first three elements of the policy.

28. The last element of the policy enables us to monitor the uptake of the proposed rules and identify areas where potential harm may be arising.

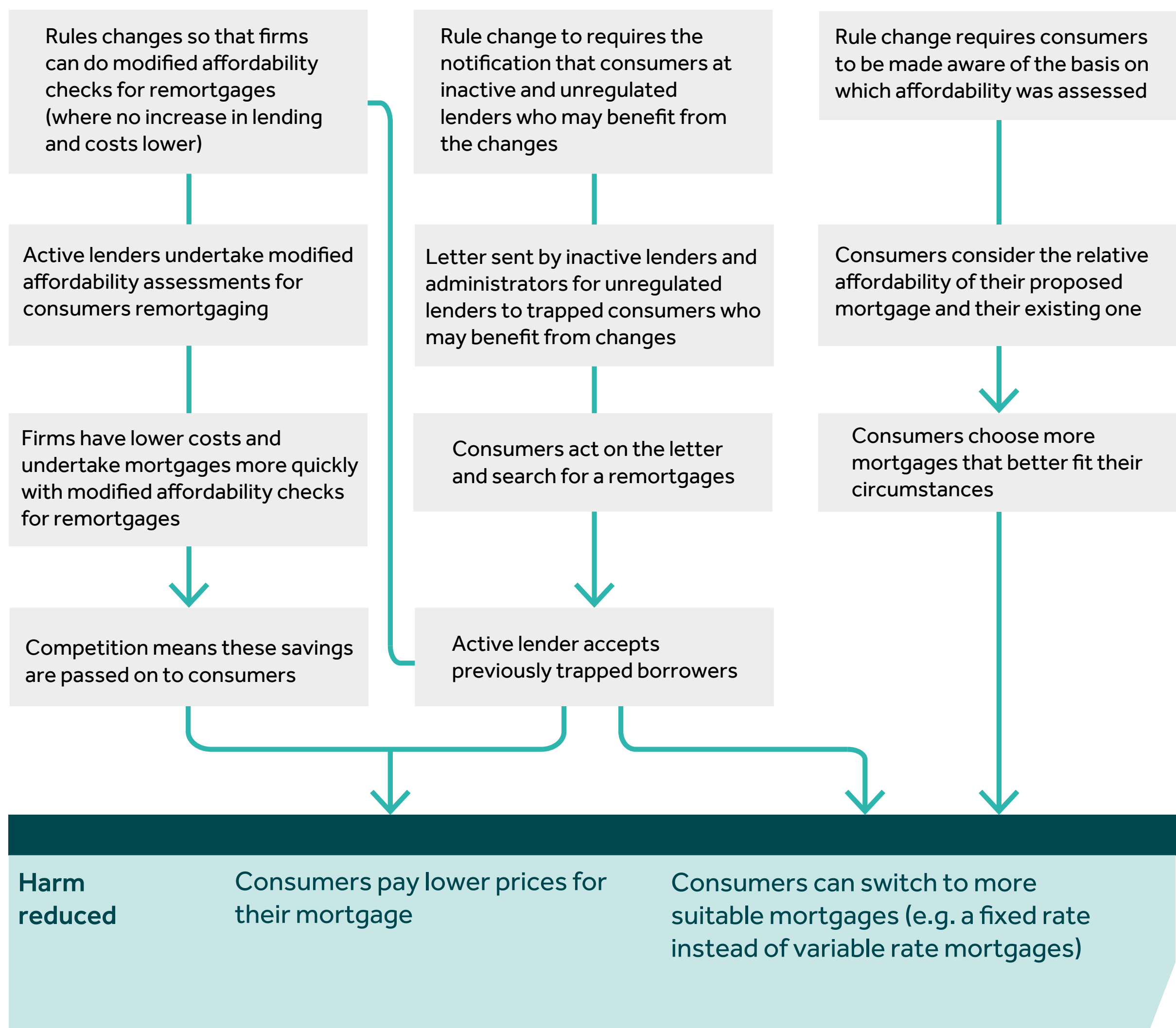

Figure 1: Causal chain

Baseline and key assumptions

29. There are a number of different firms and consumers potentially affected by our proposals.

30. There are currently around 180 active mortgage lenders and around 7,000 mortgage brokers. There are also around 215 mortgage books held by inactive lenders and unregulated entities that are also affected.

31. There are two different groups of consumers affected by our proposals:

- Consumers who potentially cannot switch
- Consumers remortgaging with no additional borrowing

Consumers who potentially cannot switch

32. There are those consumers who currently cannot switch from their current mortgage to a new mortgage deal. These consumers will benefit if the proposals result in their being able to switch to a more affordable mortgage. Some of these consumers will

be prevented from moving because they are high-risk borrowers to lend to. However, there are other consumers who lenders would like to offer a new mortgage deal to who are currently prevented from doing so by our affordability rules.

33. We estimate that inactive lenders and unregulated entities will need to send communications to up to 500,000 consumers. Only some of these consumers would be eligible to switch, and benefit from switching. Many of these consumers will not benefit from switching as they are on lower interest rates, or are not eligible for mortgages at other lenders.

34. Over time the mortgages of those consumers that currently cannot switch will slowly be paid-off. The data we use for our analysis was collected in 2016, we have therefore applied simple assumptions to take into account the effect of time on these mortgage books. For example, some mortgages reach term, or are so near term that consumers would not be able to switch. We exclude these consumers from our estimates of those consumers who may benefit. However, we have not assumed other reductions in the number of consumers who cannot switch for other reasons, eg sale of the property.

35. We are aware that there are some consumers who may be unable to switch in the future because their circumstances have changed since they took out their mortgage or last switched. We do not think there will be many such consumers as affordability assessments under the current requirements (post-MMR) are to higher standards than before the 2008 financial crisis (and our research suggests that the large majority of consumers who cannot switch took out their mortgage before the financial crisis). This will limit the likelihood of consumers becoming unable to switch in future in the same way as the cohort we have seen. Additionally, we would expect fewer firms to become inactive compared to the number we saw post-crisis so we have not made assumptions about new consumers who cannot switch in the future.

36. We assess the size of the interest savings to consumers over the five years following their switch to a lower-priced mortgage. We have not assessed benefits after this point as the benefits become more uncertain. For example, as the population of borrowers ages, we might see more consumers ending their mortgages.

37. There are two key reasons why our estimates of the impact of our proposals are uncertain. We do not have directly relevant evidence on

- the extent to which consumers respond to the communications they receive that prompt them to switch to a new mortgage lender
- the extent to which lenders accept consumers that previously would have failed affordability assessments.

38. To reflect this uncertainty in our estimates, we use two scenarios for the extent to which consumers switch to a new mortgage lender. In our low scenario, we assume that between 5% and 30% of consumers who are eligible to switch, and would benefit from switching are able to. In our high scenario, we assume between 50% and 70% of consumer consumers who are eligible to switch, and would be benefit from switching, do so.

Consumers switching with no additional borrowing

39. There are also consumers that switch to a new mortgage deal with a new lender, without taking on any further borrowing, who are not prevented from switching by our

rules. These consumers will, however, benefit from a more efficient switching process as result of our proposals. Currently, the firms providing mortgages to these consumers must undertake an affordability assessment. We estimate that there are around 150,000-250,000 consumers per year in this position who will be affected. We assume that the number of switches with no additional borrowing remains at the level we have observed in the last few years. We see no reason to believe that the number of such remortgages would materially deviate from this range.

Summary of costs and benefits

40. The following table sets out a high-level summary of the costs and benefits of our proposals.

	One-off / ongoing	Costs	Benefits
Lenders	One-off	Familiarisation and gap analysis - £1.6m Identification and Communication costs – £1.2m Lender system costs (including reporting costs) - £3.2-13.0m Loss of revenue from consumers switching to another lender – £8-47m. Switching costs - £3.5-£20.8m	Higher sales to newly switching consumers – Not quantified
	Ongoing		Lower costs of affordability assessments – £2.0-3.3m More efficient switching process – not quantified Lower default levels – not quantified
Consumers	One-off	Time to search and switch - £0.03m-0.3m	Lower mortgage rates - £8-47m Lower default levels -not quantified
	Ongoing		Lower time costs when switching - £0.4-0.7m More efficient switching process -not quantified

Table 1: Summary of the CBA

41. For the overall affordability changes, we note that firms would only implement modified affordability assessment when the benefits of doing so are greater than the costs. These changes are, therefore, inherently proportionate.

42. At paragraphs 3.15 and 3.16, we ask for respondents to consider whether our definition of a more affordable mortgage should include the reversion rate of the new mortgage. The effect of this change would be to lower the numbers of consumers that would remortgage using the modified affordability assessment. It would also reduce the number of firms who would benefit from the changes as few consumers remortgaging with them would be eligible for the modified affordability assessment. Given that firms

have the choice to implement the modified assessment, and they would only do so where the benefits to firms are greater than the costs, this would still be net beneficial.

43. We also note that the we consider applying these changes to home movers (see paragraphs 3.40-3.42). The effect of these changes would be to increase the numbers of consumers potentially eligible for the modified assessment, and also increase the incentives for firms to change their systems to enable them. We are unable to identify the number of consumers moving home that would be able to use the modified assessment as the data we collect through PSD do not allow us to match consumers old and new mortgages when they move.

44. Our analysis assumes that all firms apply affordability assessments. Excluding the communications elements of the policy (those elements only affect affecting inactive lenders, and administrators acting for unregulated entities), the upper bound of total costs of the changes including systems costs and familiarisation costs are £14.6 m. We assess cost savings over 10 years using HM Treasury Green Book discount rate of 3.5%. We expect the overall cost savings to be at least £17.1m. This does not include the small time saving for consumers.

45. If some firms choose not to use modified affordability assessments, we would expect the fall in costs to be greater than the reduction in benefits. Hence the proposals would still be proportionate even with lower take-up of the modified assessment.

46. For the additional requirements for mortgage lenders to review their customer books and contact relevant consumers, we have considered how the net benefits scale up as more consumers switch, to ensure our proposal remains proportionate at different levels of switching. On average we would expect consumers to save around £4,400 (excluding fees) if they switch. Using our estimates for the costs of switching (and assuming these are all born by the consumers), consumers would save £2,900 on average in the five years after switching. We found that the communications cost for firms was around £1.2m. We only require around 500 consumers to switch before the interest savings for consumers outweigh the costs of the communication exercise. This is only around 1% of the consumers who we think could benefit from switching and would be able to do so.

Benefits

47. This section sets out the benefits of our proposals.

48. First, we set out the interest savings for consumers who hold mortgages with inactive lenders and unregulated entities who currently cannot switch. Consumers who can currently switch but have mortgages with these firms may also benefit if the communication prompts them to move to a better rate.

49. Second, we estimate the benefits to lowering the cost and resources to undertake affordability assessments for consumers that are switching without taking on additional borrowing, and who aren't currently prevented from switching.

50. Third, we analyse the more uncertain benefits that arise from a more efficient switching process and the potential benefit of lower mortgage defaults.

Consumers

Interest savings for consumers

51. By reducing some of the regulatory barriers to consumers switching mortgage, we would expect more consumers to switch to lower priced mortgages. We would also expect the proposed communication to consumers of inactive lenders and unregulated entities to prompt some of these consumers to switch even if they were not previously unable to switch to a new lender.

52. We used the sets of information we collected as part of the Market Study on the books of inactive lenders and unregulated entities to estimate the number of consumers that might benefit from the proposals (these data cover all the relevant affected mortgages). We used:

- regulatory returns (mortgage product sales data (PSD)) provided by authorised lenders and submitted to the FCA on mortgages held in 2016
- a mix of portfolio-level and account-level data on accounts on closed books held by inactive and unregulated lenders, collected by the FCA in 2016 and 2017

53. Where we have account level information we used the following approach to identify the consumers that might benefit from switching and their potential savings if they did switch. First, we accounted for the time that had elapsed since the data were collected for the Market Study. We removed mortgages that had reached term or nearly reached term. We also reduced the balances of mortgages on capital repayment to take into account that consumers would have paid down some of their balances since 2016.

54. Using information on the mortgage, we next assessed the extent to which consumers would be eligible for alternative deals. The table below sets out our assumptions on the alternatives available to borrowers of different levels of riskiness. To do this, we assumed the 3.69% benchmark identified in the Market Study (the lowest standard variable rate offered in the market at the time of the analysis) was the best possible alternative rate for those borrowers who had a loan to value below 90% and were not credit impaired. An additional premium was added to the alternative rates to take into account the higher risk of other borrowers.

Loan to value	Not credit impaired	Credit impaired*
<90%	3.69%	3.10%
>90% but <95%	4.44%	Not available
>95% but <100%	5.44%	Not available

* Those consumers that entered a mortgage with an impaired credit history.

Figure 2: Alternative possible mortgage rates for mortgage prisoners

55. Using these assumptions, we calculate the number of consumers who would potentially benefit from switching to an alternative mortgage product, if they were eligible.

56. Where we do not have consumer level information on the mortgages held by unregulated entities, we undertook the same analysis as above but at the book level. This does introduce uncertainty into our estimates. This is because there may be consumers in these books who may be helped by our proposals whom we discard as the average characteristics of those in the mortgage book suggest they cannot be

helped. To enable us to estimate the potential savings for the consumers in these books, we assume that they have similar characteristics to those we have consumer level data on. For example, we assume they have similar mortgages terms and a similar proportion of consumers are on interest-only deals.

57. We then compare their current mortgage payments with the payments they would make on the hypothetical alternative mortgage. We assume that consumers remain on these products until maturity. We assume that there will be fixed costs in switching mortgages of £1000 borne by the consumer (this cost could be passed on in a fixed fee or higher interest rates).This leads us to an estimate of the pool of consumers that could potentially benefit from switching, and who may do so, as a result of our proposals.

58. Relatively small changes in the alternative interest rates available to consumers has a material impact on the consumers that would benefit from switching to an alternative mortgage product for which they are eligible.

59. Since the data used in our analysis was collected in 2016 and 2017 for our Market Study, there appears to have been a widening in the differential between the rates available to consumers on high loan to value mortgages and reversion rates. The chart below shows that, over the period since the data was collected, the differential has increased by over 50 basis points, and in some instances the differential is even higher.

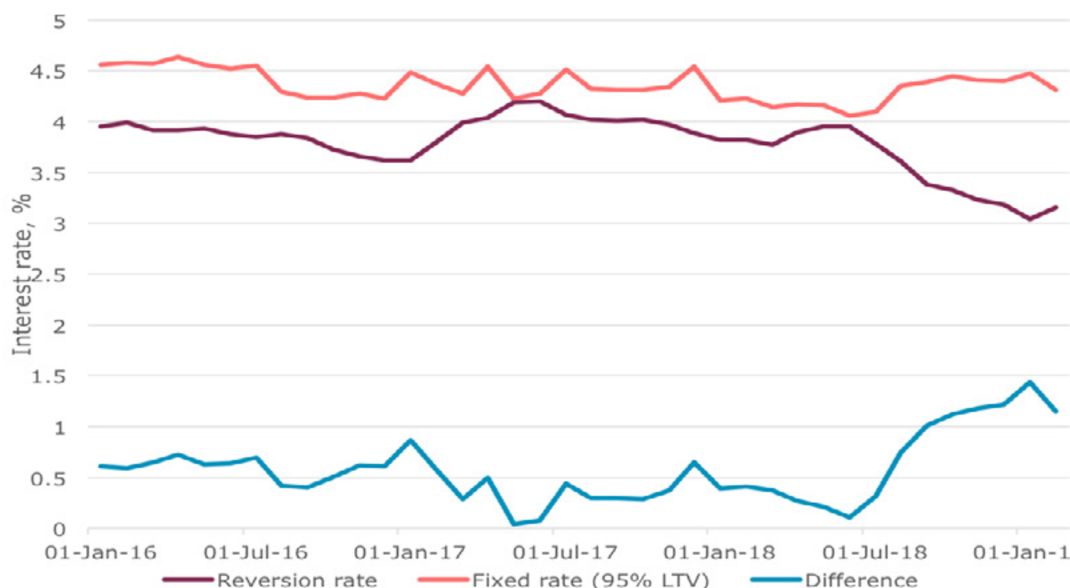

Figure 3: Interest rates on high LTV mortgages and reversion rate mortgages

Source: Bank of England, Interest and exchange rates etc, series IUM2WTL and IUMTLMV

60. To take into account the uncertainty of the alternative rates available to consumers, we undertake the same analysis as above but reduce the alternative rates available for consumers by 75 basis points. This creates an upper bound on our estimate of the number of consumers who could benefit from the proposals if they switch.

61. We therefore estimate that the pool of consumers that could potentially benefit from switching, and who may do so, as a result of our proposals to be 45,000-65,000 consumers. It is important to note that there is uncertainty in this estimate, given limited data, and it is used to illustrate the potential scale of benefits.

62. Considerable uncertainty arises from our limited knowledge about books held by unregulated firms. It is possible that there may be more consumers who could potentially benefit from our proposals. However, we are unable to determine whether there are more consumers who may do so.

63. In our estimates of the benefits, we take a conservative approach and use the lower bound estimate of the number of consumers who we think are eligible to switch and who would benefit from doing so (ie 45,000).

64. We also have limited evidence on the extent to which consumers will switch to other lenders as a consequence of our changes. This is due to two effects that are both uncertain.

65. First, consumer communications can have relatively small effects. We have undertaken a number of trials of disclosure and we do not see large effects. These findings are also borne out in the literature on disclosure. For example, we found the disclosing last year's premium for home insurance customers increased consumers response by 3.2% and that that as the potential saving increased the response increased 5%.

66. However, we note that in this case, we might expect larger responses. This is because we see relatively high switching rates in the mortgage market generally. The potential savings for consumers could therefore be considerable. We therefore think the effect of the communications will be larger than we have seen in other markets. In the Mortgages Market Study, we found that nearly 70% of consumers had switched within a year of their introductory rate on their mortgage ending.

67. Second, our rules are not the only constraint on firms offering mortgages to consumers. Firms may not be willing to take on some higher-risk consumers at interest rates lower than consumers are currently paying.

68. We therefore assume a large range for the potential benefits to consumers due to the considerable uncertainty in the number of consumers that will search for a new mortgage and be accepted by a lender.

69. Given the uncertainty and the high potential savings for consumers, we consider a range of levels of consumer engagement and switching.

70. As a starting point, we assume that, of the pool of consumers that might benefit from switching, between 5% and 30% of the 45,000 consumers identified above are successful in transferring to a new mortgage lender.

71. Using this approach, we can estimate the potential saving for consumers. We estimate that there are between 2,000 and 14,000 consumers who would be able to switch to a better deal as a result of our proposals.

72. We assess the size of the interest savings to consumers over the five years following their switch to a lower-priced mortgage. We have not assessed benefits after this point as the benefits become more uncertain. For example, as the population of borrowers ages, we might see more consumers ending their mortgages.

73. Consumers typically switch more often than 5 years and therefore it could be argued that we should assume some additional switching. However, in line with the Market Study findings, we assume these consumers switch on to cheaper reversion rates rather than the best introductory rates in the market. This is because of the risk profile of the consumers.

74. It could also be argued that we should consider a longer time period for assessing benefits to consumers. Given the age of the mortgages affected, we might expect that the benefits will decline in the longer term as mortgages are closed, as properties are sold or consumers take advantage of retirement interest-only mortgages as they are post-retirement age.

75. To estimate the saving to consumers, we calculate the difference in the mortgage payments under consumers' existing mortgages with the alternative mortgage payments they would pay under the new mortgage if they switched.

76. Using these assumptions, we estimate the 5-year savings to consumers of £8-47m.

77. If we assume that 50-70% of consumers switch, then this would mean 23,000- 32,000 consumers would switch. We estimate that the 5-year savings accruing to these consumers would be £79-110m.

Lower costs of affordability assessments

78. The proposed modified assessments for consumers who are looking to switch without taking on additional borrowing will reduce the time spent on affordability assessments. We would expect most of the time saved would arise through a quicker and more efficient process.

79. In the MMR, Oxera estimate of the mortgage affordability assessment was around £11.50 per transaction. Most attempts to switch are likely to be successful and therefore we use the £11.50 estimate to estimate the saving from our changes. Accounting for inflation, this implies that the cost will be around £13 per transaction.

80. The number of consumers switching to a new lender each year varies considerably, as does the number switching with no additional borrowing. Using data from PSD001 from the period 2015-2018, we estimate that there are between 150,000 and 250,000 consumers switching each year where there is no new borrowing.

81. Combining these pieces of information, we estimate the savings to firms from undertaking modified assessments will be between £2.0m and £3.3m per year. We assume that all firms will apply the modified affordability assessment where they can. We would expect that competition would lead to at least some of these savings being passed to consumers.

82. If the modified affordability assessment can only be used when the reversion rate on the new mortgage is lower than the existing mortgage then this will limit the use of the modified assessment. This will reduce the take-up and hence the benefits of the modified affordability assessment. We note that the change may create some incentive for firms to adjust their reversion rates so that they can use the proposed modified assessment more often.

Consumer time savings from simpler affordability assessments

83. Modifying the requirements for affordability assessments for consumers switching with no additional borrowing will also mean that consumers save some time. In line with the assumptions we use for estimating the time saving for firms, we assume that consumers do not need to spend 30 minutes providing information for the affordability assessment.

84. Using this assumption and using the assumption that between 150,000 and 250,000

consumers remortgaging would make time savings, consumers would save between 75,000 and 125,000 hours.

85. To estimate the costs of searching, we value an individual's leisure time based on the Department for Transport's analysis and modelling. This provides an hourly value of £5.70 per hour (2018 prices).

86. Using these assumptions, we estimate the saving to consumers at £430,000 to £710,000 per annum.

More efficient switching

87. The proposed changes allowing for modified affordability assessments will allow for more efficient and timely switching. Reducing the time and effort required to switch may mean that the overall process becomes more efficient and simpler. It may also mean that consumers are more willing to switch to a new mortgage lender and this may lead to more competition for those switching. Such efficiencies may mean that more consumers switch or at the margin choose better value mortgages.

88. We do not think that it is reasonably practicable to estimate these benefits as the savings are dependent on the extent to which firms change their sales process as a consequence of our proposals. These changes are difficult to predict as we would expect firms to improve the process over time.

Lower levels of defaults

89. As we noted in our section on harm, if consumers pay lower interest payments they are less likely to get into arrears or default. Therefore, consumers who switch as a result of our proposals to lower cost mortgages will be less likely to get into arrears and default. We do not think these benefits will be particularly large but both firms and consumers will benefit from lower default rates and the costs that result from arrears and default. There are serious consequences for arrears. These include the psychological impact of arrears and repossession, such as stress and anxiety, as well as financial costs.

90. We do not think it reasonably practicable to estimate these savings as it is hard to disentangle the extent to which higher interest payments reflect higher risk (ie likelihood of defaults) rather than defaults being caused by higher interest rates. These benefits will be shared between consumers and firms.

Costs

Familiarisation and gap analysis costs

91. We assume that both lenders and intermediaries will seek to understand the changes we are proposing. Administrators acting for unregulated entities, and inactive lenders, will need to understand the communication requirements. In total, there are around 4,100 firms that may be affected by our proposals. Most of these firms are intermediaries (we exclude appointed representatives from these calculations).

92. We use standard assumptions to estimate these costs. We anticipate that there will be approximately 40 pages of policy documentation that firms will need to familiarise themselves with. Assuming that there are 300 words per page and a reading speed of 100 words per minute, it would take around 2 hours to read the policy documentation. It is further assumed that 20

compliance staff at large firms, 5 staff at medium firms, and 2 compliance staff at small firms read the documentation. Finally, the hourly compliance staff salary is assumed to be £57 at large firms, £61 at medium firms, and £44 at small firms, including overheads. Using these assumptions, we expect total one-off industry-wide costs of familiarisation of approximately £950,000.

93. We do not expect all firms to have to do a legal review of the new requirements against current practices – a 'gap analysis'. This is because most of the proposals are permissive rather than prescriptive. We do not expect all intermediaries to do such an analysis as the proposals do not directly affect their activity. However, we would expect lenders and administrators acting for unregulated entities to conduct such a review of these proposals. We, again use standard assumptions to estimate these costs.

94. There are around 12 pages of legal instrument to review. It is assumed that 4 legal staff at the largest firms, 2 legal staff at medium firms and 1 member of legal staff at small firms will review the legal instrument. It is further assumed that each legal staff member can review 50 pages of legal text per day. Finally, using data on salaries from the Willis Towers Watson UK Financial Services survey the hourly legal staff salary is assumed to be £67 at large firms, £67 at medium firms and £53 at small firms, including 30% overheads. Using these assumptions, we estimate that the total one-off legal review costs would be £610,000.

95. In total, we estimate one-off familiarisation and gap analysis costs of £1.6m.

Identifying and communicating with mortgage prisoners

96. Administrators acting for unregulated entities, and inactive lenders, will need to provide a one-off communication to consumers that might be eligible for switching to a more affordable mortgage. This will involve three stages. The consumers in question need to be identified. The communications need to be developed. Finally, the communications need to be sent to consumers.

97. We estimate that there are around 215 mortgage books (a portfolio of mortgages either that were purchased as a block from a specific lender or the mortgages held by a regulated inactive lender) held by inactive lenders and unregulated entities where there will be a need to contact borrowers that may benefit from our proposals. We expect that for each book, firms would identify the consumers and develop the communications separately. This may have the effect of overestimating the costs as communications may be developed over all the mortgages held by a firm collectively rather than on for each book held. There may also be some overlap between these books and synergies in the costs of the communication.

98. We expect that for each mortgage book it will take fewer than 8 person days for the communication to be developed and for the eligible consumers to be sent a communication. This would be undertaken by a team of staff comprising analysts, designers, project managers, etc with an average salary. This would include analyst time identifying customers that meet the following criteria:

- on a reversion rate
- up to date with payments
- have a residential mortgage that is not a lifetime mortgage

99. Assuming a weighted average salary cost (including 30% overheads) of £85,000 per year per book, we estimate the cost per book of the communication to be developed to be around £3,000 (we assume 220 working days per year).

100. We therefore estimate an overall one-off cost of around £670,000.

101. As we noted in the baseline section, we estimate that there are up to 500,000 consumers with inactive lenders and unregulated entities who meet the criteria above and should be sent a communication. We estimate this by using the data we collected for the Mortgages Market Study and applying the criteria for being sent a communication.

102. We note that this is more than the number of consumers that could benefit from switching or would benefit from our proposals. This is because of the relatively large number of consumers who have mortgages with inactive lenders or unregulated entities and meet the criteria set out above at paragraph 98.

103. We note that many of these consumers may not be able to switch to an alternative mortgage or would not benefit from such as a switch but we do not have granular information on specific mortgages contracts to more accurately identify those consumers that will be eligible. For this reason, we consider this estimate to be an upper bound for the number of communications sent by firms.

104. Assuming that it costs around £1 for each communication as each consumer is sent a separate letter through the post, we estimate the costs of the one-off communication exercise to be around £500,000.

105. We note that our proposed rule requires the communication to be sent in a 'durable medium', so the communication could be sent by email. Communications sent in this way would be cheaper than letter and hence would reduce our estimated cost of sending communications.

106. Where the mortgage book is owned by an unregulated entity, these costs may fall on either the administrators or the unregulated entity. The extent to which these costs fall on either party will depend on the specific contracts between the two parties.

Lender system costs

107. Lenders would incur one-off costs to change their systems so that a modified assessment can be applied to eligible consumers. These costs are an indirect result of the proposed changes as firms are not required to make the change. We would expect that firms undertaking changes would also incur some governance costs.

108. Oxera estimated the one-off (i.e. mainly system) costs of implementing the affordability requirements for the MMR in 2010. They found that most lenders already had some models to assess affordability. They found that the average one-off costs were £700,000 for large lenders (those with an outstanding mortgage book of more than £9 billion) and £25,000 for small lenders. Increasing these costs with inflation leads to estimates of £800,000 and £29,000 respectively.

109. We would expect these costs to be an upper bound to the costs of changing systems for the changes presented here. The systems costs required to implement the modified assessment is likely to be much smaller than the systems costs required to implement the MMR affordability requirements. This is because the changes we propose here, while similar, will not require the same level of systems changes as the MMR changes. Consequently, to estimate the range of costs, we assume that lenders will incur between 10% and 40% of these costs.

110. If all 180 active lenders implemented these changes, with around 35 large lenders (assessed at the firm rather than the group level) as defined by the original Oxera research, then we estimate one-off costs to firms of £3.2-13.0m.

Reporting costs

111. There are going to be some reporting costs for lenders that provide mortgages and have applied the modified assessment. We think that these costs will be incurred in the wider process of changing systems to enable mortgage sales on the basis of a modified assessment. The costs are therefore estimated as part of the lenders' system costs above.

Loss of revenue for inactive lenders and unregulated entities

112. If consumers of these firms find alternative mortgages and switch away, this will represent a loss of profits for these inactive lenders and unregulated entities. Most of this loss will be a transfer from inactive lenders and unregulated entities to consumers. There may also be a transfer from inactive lenders or unregulated entities to active lenders as the active lenders will earn some profits on these switched mortgages that were previously held by the old firm (the inactive lender or unregulated entity).

113. Our estimate of these costs to firms (ignoring the transfer between firms) is equal and opposite to the benefits we estimate for consumers.

114. We have not estimated the profits that are transferred from inactive to active consumers. We note that these transfer net out in the overall analysis.

115. In our section on the benefits on interest savings we estimate the potential interest savings to consumers. Given the uncertainty of the precise extent to which consumers will respond to these proposals (especially the communication) and the appetite for active lenders to lend to certain of these consumers at lower rates, it is difficult to estimate these costs.

116. We use two scenarios - a low and a high scenario - for the extent of consumer switching. This is based on identifying consumers who we think may be eligible for alternative rates and a plausible alternative rate if they switched.

117. In the low scenario, firms would lose £8m to £47m in the first 5 years following the policy.

118. In the high scenario, firms would lose £79m to £110m in the first 5 years following the policy.

Costs associated with switching

119. There is an administration cost when consumers switch mortgage lender. This involves closure of the existing mortgage and setting up the new mortgage. These costs would include the costs of legal work for the old lender to discharge the mortgage and prepare paperwork for the Land Registry; and for the new lender to investigate title, prepare the mortgage deed and register the new charge. These costs are directly proportional to the number of consumers that switch.

120. We assume that the costs of switching mortgages are up to £1,500. These costs are incurred by both the old and the new lender, with most of these costs borne by the new lender. We would expect the element of these costs incurred by the new lenders will be passed on to consumers, either through fixed fees or higher rates of interest (assuming £1000 as the approximate costs for setting up a mortgage). We would expect the costs to the previous lender would be borne by that firm (the remaining £500), unless the lender can do so under the contract. Some of these costs would also be borne by the consumers if the mortgage has an exit fee.

121. The costs of switching to the existing lender may not be totally new costs. All lending will have an end date at which point the contract needs to be ended. When a consumer switches their mortgage before the end of the contract, the discharge costs are brought forward rather than totally new for the existing lender.

122. Consumers that take advantage of their new ability to switch may subsequently switch internally onto new mortgages. Given the uncertainty of the number of consumers that will switch initially, we do not think it is reasonably practicable to estimate these costs.

123. We use two scenarios of switching to assess these costs (see the section on interest savings for consumers with unregulated entities or inactive lenders in the benefits sections for explanation of these scenarios).

124. If we use our lower bound of switching estimate for these costs (assuming 2,000 -14,000 consumers switch), then the costs of switching will be £3.5m-20.8m.

125. If we use our higher bound of switching estimate for these costs (assuming 23,000 -32,000 consumers switch), then the costs from switching will be £34.7m-48.6m.

Consumer costs

126. The proposals, especially the proposed communication, will lead some consumers to search and switch mortgages when otherwise they would not have done. In some instances, consumers would search for an alternative mortgage and may not be successful. As we explain in the benefits sections, there is considerable uncertainty as to the extent to which consumers will search and then find an alternative product.

127. To estimate the costs of searching, we value an individual's leisure time based on the Department for Transport's analysis and modelling. This provides an hourly value of £5.70 per hour (2018 prices).

128. We assume that consumers that are prompted to search for, and potentially switch to, a new mortgage will spend around 2-4 hours in doing so. The cost for the time spent search and switching would be around £11-23 per consumer.

129. We would expect those consumers who are unsuccessful in finding an alternative mortgage product to have lower costs than those that do, as they would not switch.

130. As explained in our section on interest savings in the benefits section, we estimate two scenarios for the number of consumers switching.

131. Using the range of consumer response, we describe in the benefits section for the lower scenario, we assume costs to consumers of between £30,000 and £320,000 from the time costs of searching and switching for the 2,000-14,000 consumers.

132. If we use the scenario with higher switching rates where 23,000-32,000 consumers switch, the costs would be £260,000 - £740,000.

133. Taking both scenarios into account, we estimate that the switching costs are between £30,000 to £0.7m.

Impact on intermediaries

134. We would expect most of the impacts set out in the above analysis will fall mainly on consumers and lenders (and their administrators) rather than on intermediaries. However, some of the impacts of the proposals on sales will potentially affect intermediaries. Given affordability assessments are the responsibility of lenders rather than intermediaries, we would expect the costs and benefits to mainly fall on lenders. Some intermediaries will benefit from the reduction in information requirement needed for the modified assessments rather than lenders.

135. Higher levels of switching will also increase sales of mortgages by intermediaries. We would expect these firms to receive a relatively small proportion of the switching costs we identified in the costs of switching section as profits.

Annex 4
Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

5. This Annex includes our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. The proposals set out in this consultation paper (CP) are primarily intended to advance the FCA's operational objectives to secure an appropriate degree of protection for consumers and to promote effective competition in the interests of consumers.

- They are designed to protect consumers with existing mortgages, who are up-to-date with payments and who are not looking to borrow more, from the harm of paying unnecessarily high mortgage payments by reducing regulatory barriers to them switching to a more affordable mortgage.
- Reducing regulatory barriers to consumers switching to a new mortgage should also help drive competition between lenders.

8. We also consider that these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well. The proposals aim to address the market failure that some customers are currently unable to switch to a more affordable mortgage despite being up-to-date with their current higher mortgage payments and to mitigate the risk of this occurring again in future. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by s. 1F FSMA.

9. Where a consumer does not face any potential barrier to switching under our rules, there is a time and financial cost associated with having to undergo the affordability assessment in our current rules. By providing for a more proportionate affordability assessment, we consider that we can reduce the time and cost associated with switching overall.

10. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

The need to use our resources in the most efficient and economic way

11. We consider that the proposals are compatible with this principle, on the basis that we have identified specific harms to certain consumers from not being able to switch to a more affordable mortgage and want to reduce the chance of this happening in future. We consider that it is proportionate to use FCA resources to design and consult on remedies to address these current and potential future harms.

The principle that a burden or restriction should be proportionate to the benefits

12. We have carefully considered the proportionality of our proposed interventions. We have identified and, where possible, quantified the costs likely to result from our proposals. We consider that these costs are proportionate given the expected benefits that we have identified and, where possible quantified, as set out in Annex 2.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

13. We have had regard to this principle in developing our proposals. Given that our new rules only apply to consumers who already have an existing mortgage we do not think that our proposals will have a negative impact on sustainable growth in the UK economy in the medium or long term.

The general principle that consumers should take responsibility for their decisions

14. Consumers who are able to switch to a new mortgage deal using the proposed modified assessment will be given information on the basis on which their affordability has been assessed and provided with some additional disclosures. Consumers will be expected to take responsibility for their switching decision.

The responsibilities of senior management

15. The Board of a lender will need to decide if and when the modified assessment will be applied in their lending. Their responsible lending policy will have to be amended accordingly. Our proposals will also only allow lenders to apply the modified affordability assessment if their Board has in place, and operates, a policy for offering their existing customers the ability to switch to a more affordable mortgage product. This also creates a responsibility on senior management where the Board has this policy.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

16. We have considered differences between firms and we believe there is insufficient evidence to merit applying the proposals in a different way for different firms, including building societies. This is because we understand that the relative cost of meeting our proposed requirements will not be higher for such organisations.

The principle that we should exercise of our functions as transparently as possible

17. We have engaged with industry to discuss our concerns and develop our proposals.

Expected effect on mutual societies

18. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

Equality and diversity

19. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

20. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in Chapter 2 of this CP.

Legislative and Regulatory Reform Act 2006 (LRRA)

21. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that our proposals are:

- Transparent – We are following an established consultation process in making these rules
- Accountable – We are seeking feedback from this CP on whether stakeholders agree with our proposed approach

- Proportionate – Our proposals aim to advance our objectives without creating undue burdens on firms or adverse impact on consumers
- Consistent – Our proposals aim to ensure we set consistent expectations from businesses across the mortgage market
- Targeted – Our proposals are targeted at reducing barriers to switching. This to limit the harm of consumers who are unable to switch, despite being up-to-date with their payments, paying higher than necessary mortgage payments and reduce the risk of this harm occurring again in future.

22. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance. We have engaged with industry throughout this process, and consider that our proposals are proportionate and result in an appropriate level of consumer protection, when balanced with impacts on firms and on competition.

Annex 5
Abbreviations used in this paper

CBA	Cost Benefit Analysis
CP	Consultation Paper
FCA	Financial Conduct Authority
FPC	Financial Policy Committee
FSMA	Financial Services and Markets Act 2000
LRRA	Legislative and Regulatory Reform Act 2006
MCD	Mortgage Credit Directive
MCOB	Mortgage Conduct of Business sourcebook
MMR	Mortgage Market Review
MMS	Mortgage Market Study
PSD	Product Sales Data
SVR	Standard variable rate

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Appendix 1
Draft Handbook text

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