FINANCIAL CONDUCT AUTHORITY

Mortgages: Removing barriers to intra-group switching and helping borrowers with maturing interest-only and part-and-part mortgages

Policy Statement

PS20/11

October 2020

This relates to

Consultation Paper 20/13
which is available on our website at
www.fca.org.uk/publications

Email:
cp20-13@fca.org.uk

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1 Summary

1.1 We have been working to help borrowers affected by the impact of the coronavirus (Covid-19) crisis. We are also aware that some borrowers with 'closed book' mortgages may lack switching options. We therefore consulted in Consultation Paper (CP) 20/13 on 2 interventions to help some of these borrowers.

1.2 In CP 20/13, we set out our concerns about a possible barrier in our rules to borrowers in 'closed' mortgage books (books which are closed to new customers) switching to a new mortgage deal with a firm that sits within the same group as their current lender. We referred to this as 'intra-group switching'.

1.3 In the CP we proposed to amend our responsible lending rules so that lenders could choose not to undertake a standard affordability assessment or to use the modified affordability assessment, if a borrower seeking to switch to a new deal without borrowing more was in a closed book within the same financial group. The proposal aimed to make it easier for these borrowers to be offered a new mortgage.

1.4 In the CP we explained that adverse market conditions caused by the coronavirus (Covid-19) crisis may complicate or frustrate the repayment plans of some consumers with maturing interest-only and part-and-part mortgages.

1.5 We proposed to issue temporary guidance for borrowers with a maturing or recently matured interest-only or part-and-part mortgages who are up-to-date with payments. We proposed that firms should allow these borrowers to delay repayment of the capital on their mortgage up to 31 October 2021, if they need to, providing they continue making interest payments.

1.6 Overall, respondents supported both our proposals. We are implementing the proposed rule change for intra-group switching, and implementing the proposed temporary guidance on interest-only and part-and-part mortgages subject to some minor changes (see paragraph 1.30).

Who this affects

1.7 This Policy Statement (PS) will be directly relevant to:

- mortgage lenders
- mortgage administrators, including those acting on behalf of unregulated entities
- mortgage customers in a closed book
- mortgage customers with maturing interest-only or part-and-part mortgages

1.8 It will also be relevant to stakeholders with an interest in the mortgage market, including:

- credit reference agencies
- trade bodies representing mortgage firms
- consumers and consumer organisations
- charities and other organisations

The wider context of this policy statement

Mortgage Market Study

1.9 Our Mortgage Market Study (MMS) found that the mortgage market works well in many respects as there are high levels of switching, with a range of products on offer and apparent competition on headline rates between lenders.

1.10 But it also found that some borrowers face barriers to switching. Some are unable to switch despite being up-to-date on mortgage payments, and, depending on their loan and borrower risk characteristics, are potentially paying more than they need to. These borrowers are often described as 'mortgage prisoners'.

1.11 In response to the MMS' findings, 2 initiatives were introduced to facilitate switching- an industry voluntary agreement and our modified affordability assessment.

Industry voluntary agreement and modified affordability assessment

1.12 In 2018, lender trade bodies responded to the findings of the MMS with a voluntary agreement, with 67 lenders, reflecting around 97% of the market, committing to enabling existing borrowers on a reversion rate to move to a better deal, where they meet certain criteria. Examples of these criteria include being up-to-date with payments, and borrowers having a minimum of 2 years or £10,000 left on their mortgage. This has enabled eligible borrowers to move to an alternative product provided by their current lender, if they request it.

1.13 In October 2019, we responded to the findings of the MMS by introducing new rules (PS 19/27) to remove barriers to switching to a more affordable mortgage for mortgage prisoners and other eligible borrowers. However, as a result of the coronavirus pandemic, lenders have reported that they will be unable to offer a range of switching options or have processes and systems in place to support remortgaging under our amended rules as quickly as originally anticipated. We are pleased that some lenders have started to offer some solutions, and will continue to work with our Implementation Group on the availability of switching options.

Coronavirus pandemic

1.14 The economic conditions caused by the coronavirus pandemic have had a significant impact on the mortgage market. The FCA, alongside Her Majesty's Treasury, has worked with industry to support mortgage borrowers in temporary financial difficulty. Our temporary guidance enabled 2 key measures:

- mortgage payment deferrals
- a pause on repossession action until 31 October 2020

1.15 This temporary guidance expires on 31 October 2020.

1.16 On 14 September we published finalised guidance setting out how firms should provide tailored support to borrowers who have benefitted from payment deferrals under the June guidance and who continue to face financial difficulties, as well as those whose financial situation may be affected by coronavirus after 31 October.

Statement on Mortgage Prisoners

1.17 In July 2020, we published a Statement on mortgage prisoners, in which we presented further analysis we have done on borrowers with inactive firms, including mortgage prisoners. It set out actions we have taken to help mortgage prisoners and outlined further support for borrowers who are struggling, including new dedicated support from the Money and Pensions Service.

How our proposals link to our objectives

1.18 The new rule on intra-group switching supports our objective of securing an appropriate degree of protection for consumers. By reducing regulatory barriers to lenders offering a new mortgage deal to borrowers whose mortgage sits in a closed book within the lender's financial group, we hope to make it easier for these borrowers to switch to a cheaper mortgage deal. We expect a limited impact on competition from our proposal to remove barriers to switching. Any impact on competition might be neutral or positive given that it may enable greater switching.

1.19 This temporary guidance also supports our objective of securing an appropriate degree of protection for consumers. It builds on Principle 6 ('a firm must pay due regard to the interests of its customers and treat them fairly'), and seeks to minimise potential harm to borrowers with interest-only and part-and-part mortgages which have matured recently or are set to mature soon in these unique, adverse market conditions.

What we are changing and the outcomes we are seeking

Our rule change

1.20 Some borrowers' mortgages are in a closed book that sits within the same financial group as an active lender. Currently, lenders have to conduct an affordability assessment before offering a new mortgage deal to borrowers who sit within their group, but with a different lender. We want to remove a potential regulatory barrier that might lead to these borrowers experiencing financial harm if it unnecessarily restricts them from being able to access the rates offered by another lender in the same group. We are therefore amending our responsible lending rules so that lenders can choose to not undertake a standard affordability assessment or use the modified affordability assessment for these borrowers.

1.21 This should help some closed book customers who are within the risk appetite of the relevant lender switch to a new mortgage, which may be more affordable. While lending is a commercial decision, we hope that some firms may choose to make use of this rule change where it is within their risk appetite to do so. However, we accept that use of this enabling rule change will be limited by factors such as eligible borrowers' risk profiles, lenders' risk appetites and wider market conditions.

Our temporary guidance

1.22 We are issuing temporary guidance which builds on Principle 6 ('a firm must pay due regard to the interests of its customers and treat them fairly'). It makes clear that firms should allow borrowers with interest-only and part-and-part mortgages which have matured recently or are set to mature soon, and who are up-to-date with payments,

to continue making interest payments and delay repayment of the capital on their mortgage up to 31 October 2021.

1.23 This guidance seeks to minimise potential harm to borrowers in these unique, adverse market conditions arising from the coronavirus pandemic by giving them more flexibility, if needed, to repay the capital on their mortgages. There is significant likelihood, in the current uncertain environment, that borrowers are going to be struggling to make decisions. By enabling borrowers to take advantage of this guidance it should help avoid situations in which borrowers may struggle to realise their repayment strategy or may be concerned that they would attain poor value if they needed to repay the capital on their mortgage in adverse market conditions. Our temporary guidance issued on 14 September 2020 reconfirms that a firm should not seek to repossess a borrower's property when they are needing to self-isolate.

Measuring impact

1.24 We will measure the effect of our proposed rule change on intra-group switching through our supervision of firms, and monitoring of regulatory returns. We recognise that use of this enabling rule change is dependent on several factors, particularly lender appetite.

1.25 We will measure the effect of our proposed guidance on interest-only and part-and-part mortgages through our supervision of firms. In many cases it will still be in customers' best interests to repay their mortgage's capital upon maturity, and we expect that many eligible customers will not choose to make use of this guidance.

Summary of feedback and our response

1.26 We received 44 consultation responses – 9 from firms, 3 from trade associations, 8 from groups that represent consumers and 24 from consumers (most of whom described themselves as mortgage prisoners). We have also discussed these proposals with stakeholders.

1.27 Overall, respondents were supportive of our proposed rule change for intra-group switching. Firms and trade associations were supportive of the change, providing that its use remained a commercial decision for firms. They noted that some customers of closed books would have characteristics which placed them outside of the relevant lender's risk appetite. Consumers and groups that represent consumers were also generally supportive, but many requested that we make it compulsory for firms to make use of this rule.

1.28 We do not intend to make any changes to our proposed rule. We discuss in more detail the feedback we received on our proposed rule change and our response in Chapter 2.

1.29 Consumers and groups that represent consumers were supportive of our proposed temporary guidance. Firms and trade bodies, while supportive of the efforts to help these borrowers, were concerned that borrowers may choose to delay repaying the capital on their mortgage unnecessarily which may not be in their long-term best interests. They also raised some operational concerns around its implementation.

Some industry respondents raised concerns regarding the interest rates which firms could charge borrowers, and asked us to clarify if certain loans were included within the scope of the guidance.

1.30 We do not intend to make substantial changes to the temporary guidance. However, we have altered it to exclude bridging loans from its scope and to clarify to allow firms to charge borrowers the interest rate applicable under the existing contract. We discuss in more detail the feedback we received on our proposed guidance and our response in Chapter 3.

1.31 Consumers and some groups that represent consumers also raised wider mortgage market issues, including about the treatment of mortgage prisoners. Many of these respondents called for us to take further action which included requests for an investigation of interest rates, a cap on standard variable rates (SVRs), further research into closed books, an extension to the regulatory perimeter, a ban on the sale of mortgage books to unregulated entities and a review of our Finalised Guidance (FG13/07) on how firms should deal fairly with interest-only mortgage customers who risk being unable to repay their loan.

1.32 We have previously addressed most of these issues in detail in our Statement on mortgage prisoners. We summarise our views on these issues in Chapter 4.

Equality and diversity considerations

1.33 Our CP set out how we have considered the equality and diversity issues that may arise from our proposals. Age is a protected characteristic. Interest-only and part-and-part customers are more likely to be older and to benefit from our proposals. We do not consider that the changes materially impact any of the other groups with protected characteristics under the Equality Act 2010. We did not receive any consultation feedback on these considerations.

Next steps

1.34 The rule on intra-group switching comes into force immediately (ie on 23 October 2020). If you are a lender, you can start making use of this rule as soon as you are ready to do so.

1.35 The temporary guidance on maturing interest-only and part-and-part mortgages comes into force on 31 October 2020, and applies to eligible borrowers whose loans have matured between 20 March 2020 and will be maturing until 31 October 2021. We expect lenders and administrators to begin telling eligible borrowers about the option to delay capital repayment promptly, and we discuss this point further at paragraph 3.4.

2 Feedback and our response: Removing barriers to intra-group switching

2.1 In CP20/13, we proposed to amend our responsible lending rules so that lenders could choose to not undertake a standard affordability assessment or use the modified affordability assessment, if the borrower seeking to switch to a new deal without borrowing more (other than to finance a product or arrangement fee) was in a closed book within the same group as the lender. By 'closed book' we mean a book which is closed to new customers. We proposed that this enabling rule come into force upon publication of the PS.

2.2 In this chapter, we set out the feedback we received, and why we are proceeding with this proposal as consulted on.

Timeline for implementation of this rule change

Consultation question

Q1: ***Do you agree with our timeline for when our proposed rule change on 'intra-group switching' would come into force?***

Feedback received

2.3 There was broad support from groups that represent consumers, firms and trade associations regarding our proposed timeline for implementation of this rule change.

2.4 Some industry respondents noted that where commercial appetite exists to make use of this rule, firms may not immediately make use of it due to ongoing operational demands created by the coronavirus crisis. These might include dealing with borrowers who are coming to the end of a payment deferral granted under our emergency coronavirus guidance.

Our response

2.5 We intend to maintain our proposed timeline. This is an enabling rule, and it will be a commercial decision for lenders as to whether they choose to make use of it. As this rule will come into force from publication of the PS, lenders who choose to use it can do so as soon as they are ready.

Our proposed rule change

Consultation question

Q3: ***Do you agree with our proposal to extend our rules, that do not require a standard affordability assessment for borrowers switching with their existing lender, to include borrowers in closed books looking to switch with a lender within the same group as their closed book?***

Feedback received

2.6 There was general support for this rule change from respondents. Firms and trade associations emphasised that it should remain a commercial decision whether lenders make use of the new rule. They noted that many eligible borrowers may not meet the risk appetite of the relevant active lender, due to the poor risk profiles of many of these borrowers. In some cases the structure of securitisation agreements would also have an impact. One trade association and a firm asked us to alter this rule so that it would not apply to borrowers who wish to remortgage when they move house. One trade association asked us to alter the rule so that any broker fees could be added to a remortgage conducted using this rule.

2.7 A trade association noted that some closed books sit on legacy computer systems, and that transferring customers from these to the systems of an active lender could require a manual process or changes to their computer systems. One firm and a trade association asked us to present this change as a 'remortgage' rather than a switch. They noted that use of this rule would entail a remortgage to formally transfer borrowers between different legal entities in the same group, which would be a more complex process than when borrowers switch internally with their existing lender.

2.8 Some stakeholders asked us to make it a mandatory requirement for lenders to make use of this rule. One respondent suggested we require that all customers within a single banking group are offered the same deals. Some groups that represent consumers suggested we mandate a communications strategy from firms, to ensure that that eligible borrowers would be aware of this rule. Some were concerned that this proposal would only apply to borrowers who are up-to-date with payments, and asked for clarity on this point. One consumer group and a trade association also raised concerns regarding whether consumers would understand the full implications of moving onto a new deal.

Our response

2.9 We intend to implement these proposals as consulted on. We are aware that lenders' appetite to make use of this rule change may be influenced by a number of factors, including eligible borrowers' risk profiles, lenders' risk appetites and wider market conditions. While we hope that firms may choose to make use of this rule change where it is within their risk appetite to do so, it will remain a commercial decision as to whether firms make use of this rule. We cannot force firms to lend.

2.10 We do not believe it is appropriate to mandate a communications strategy. A mandatory communications strategy would add additional costs for firms. Also, if firms choose to use this rule, many closed book customers in their group may be outside their risk appetite.

2.11 If lenders decide to make use of this rule, then when the borrower in question remortgages this will happen under a new contract because the lender will be a different legal entity. We consider that the standard disclosure involved in this process should be sufficient for borrowers to understand the implications of their switch. We understand that the process of switching borrowers in a closed book to an active lender may be a more complex process operationally than an internal switch, especially where closed books sit on legacy computer systems.

2.12 As this is an enabling rule change, firms can choose not to make use of it where borrowers are moving house. As we have not received broader feedback suggesting that intra-group switching may be broker led, we do not believe it would be proportionate to alter the rule to include broker fees as well as product and arrangement fees, and so deviate from our established policy for internal product transfers (in MCOB 11.6.3(R)), which the new rule complements.

2.13 Unlike the modified affordability assessment this rule does not have a requirement for borrowers to be up-to-date with payments. However, it is the lender's commercial decision to make use of this rule, and we are aware that general industry practice is to not offer borrowers in arrears a new deal but instead provide more tailored support.

Cost benefit analysis

Consultation question

Q7: ***Do you have any comments on our cost benefit analysis on the proposed rule changes on intra-group switching?***

Feedback received

2.14 We received some comments on our cost benefit analysis. A few groups that represent consumers were disappointed by the number of borrowers we estimated would be helped by these proposals. One suggested that we should also have conducted a cost benefit analysis on alternative interventions.

2.15 To estimate the proportion of eligible borrowers who might benefit from switching under our proposed rules, we used an illustrative benchmark interest rate of 4%. One group that represents consumers suggested that we should have used benchmark interest rates of 1.6-1.9%.

2.16 One trade association and a few firms noted that our cost assumptions seemed to be low. However, no respondents gave an indication of the extent to which costs were underestimated, beyond a firm suggesting that familiarisation costs should include the cost of making front line staff aware of the rule change, and a trade association commenting that the costs of systems changes to enabling switching within groups were underestimated as some of the affected mortgages currently sit on legacy systems.

Our response

2.17 FSMA requires us to provide an analysis and estimation of the costs and benefits of proposed rule changes. On this occasion given the need to act quickly in the face of adverse market conditions, we did not conduct a cost benefit analysis on alternative interventions that we were not proposing to make.

2.18 The Product Sales Data we analysed was reported to us in December 2019. We used a benchmark interest rate of 4% as it was around the level of the best mainstream SVRs available on the market at the start of 2020. We believe that the proposed benchmark suggested by the respondent may be too low, given that it is much lower than the best mainstream SVRs that were available at the time we received our data. Additionally, the risk characteristics of many of the borrowers affected by our proposals may place them outside the risk appetite of mainstream lenders. As noted in our CP, not all borrowers paying interest rates above 4% would be experiencing harm relative to this illustrative 4% benchmark because their ability to access such other products depends on a number of factors including their own risk profile, and lenders' overall product portfolios, lending appetite and pricing.

2.19 Our rule changes are enabling and where the costs of intra-group switching are high, firms might decide not to use the new rule. However, we would expect our changes to help borrowers, especially where the costs of the enabling intra-group switching are low. So we remain of the view that the cost benefit analysis of our proposed rule change is accurate and our proposals are proportionate.

2.20 The instrument published in this PS does not differ from the consultation draft. So we do not consider that a new or revised cost benefit analysis is required by section 138I(5)(a) of the Financial Services and Markets Act 2000.

3 Feedback and our response: Helping borrowers with maturing interest-only and part-and-part mortgages

3.1 In CP20/13, we proposed to issue temporary guidance for borrowers with maturing or recently matured interest-only or part-and-part mortgages who are up-to-date with payments. This proposal aimed to make clear that firms should allow these borrowers to delay repayment of the capital on their mortgage up to 31 October 2021, if borrowers request to do so and if they continue making interest payments.

3.2 In this chapter, we set out the feedback we received, and why we are proceeding with this proposal.

Timeline for implementation of this guidance

Consultation question

Q2: ***Do you agree with this timeline for when our proposed guidance on maturing interest-only and part-and-part mortgages would come into force?***

Feedback received

3.3 Groups that represent consumers supported our proposal that the guidance come into force on 31 October 2020. Some firms and trade bodies raised concerns that the timeline and the requirement to contact eligible borrowers could create operational pressures. They noted that the proposed implementation date coincides with the end of our temporary coronavirus mortgage payment deferral guidance and the Government's coronavirus job retention schemes. Some raised concerns about possible resource implications for example, due to having to contact borrowers they may have already made an agreement with, as well as if significant numbers of borrowers then contacted the firm at the same time to request a delay in capital repayment. A trade body asked for flexibility of the timings of these communications, and some firms were concerned about operational bottlenecks when the guidance expires in October 2021.

Our response

3.4 We have retained the proposed implementation date. While we understand that firms are under significant operational pressure, we do not believe our guidance imposes a disproportionate additional burden. We recognise that firms may need to prioritise communications to those borrowers who have mortgages maturing in the near future or to those whose mortgages have recently matured and where the capital repayment is still outstanding. While the guidance comes into effect on 31 October, we understand that firms will not be immediately able to communicate with all borrowers affected by the guidance, and that it will take time to put appropriate systems fully in place.

3.5 If firms have contacted eligible borrowers before this guidance comes into force, and agreed that they can delay repayment of their mortgage, they do not need to contact them again under this guidance, provided borrowers were given the option to delay the repayment until 31 October 2021. If the borrower chose not to make use of an extension of up to 31 October 2021 (or longer) then there is no expectation on the firm to contact them again to make them aware of this guidance. Further, it may be the case that some firms are already allowing borrowers to delay repaying the capital and will have agreed a delay in repayment until on or after 31 October 2021 and therefore firms would not be expected to contact these borrowers again.

3.6 The guidance is not prescriptive about the format of firms' communications to borrowers. The focus for firms should be on providing sufficient clear and understandable information to enable borrowers to make an informed and effective decision given their individual circumstances. The information should clearly set out any associated risks and considerations that the customer needs to be aware of.

Our proposed guidance

Consultation questions

Q4: ***Do you agree with the guidance we are proposing on interest-only and part-and-part mortgages?***

Q5: ***Do you agree that the guidance should only apply to those up-to-date with payments at maturity and who maintain interest payments thereafter?***

Q6: ***Do you agree that the guidance on interest-only and part-and-part mortgages should be in place for 12 months?***

Feedback received

3.7 Some firms and trade bodies and a group that represents consumers were concerned that borrowers may choose to delay repaying the capital on their mortgage unnecessarily. They felt this could lead to worse consumer outcomes and future complaints if those borrowers still cannot repay by 31 October 2021. One firm asked us to encourage customers to seek advice before making use of this guidance. It was suggested that firms should be able to refuse a borrower's request to delay repayment of the capital if they do not feel it is in the borrower's best interests, especially where it was clear that a borrower is unlikely to have a repayment plan in place by the time the guidance expires. It was also suggested that the guidance should only be applied to customers who are unable to repay the capital on maturity. Some industry respondents noted that the financial and property markets might not have improved by the time this guidance expires, and one requested that we keep our guidance under review.

3.8 Some firms and trade bodies considered that lenders should be able to revert customers' mortgages onto their Standard Variable Rate (SVR) rather than retaining them on a fixed rate, or other introductory deal that expired at, or just before maturity. Firms also raised concerns that it was unfair to expect them to subsidise customers who could not repay at maturity by offering them a lower rate than their SVR. A group that represents consumers welcomed our proposal that customers who take advantage of our guidance would be charged their pre-maturity rate (or lower).

3.9 There were several requests from firms and trade bodies to exclude bridging loans from the guidance. Respondents noted that these loans generally have a term of less than a year and that it was not appropriate to offer an extension on such a short-term contract. One firm and a trade body also requested that we exclude high net worth customers from the scope of the guidance as they often have short repayment terms as well as more complex circumstances. One firm asked for clarity regarding whether the guidance would apply to buy-to-let mortgages.

3.10 Some firms were concerned about the formal process of changing the accounts of affected customers. For example, whether to treat them as formal term extensions through contract variation.

3.11 Firms and trade bodies were generally supportive of the application of the guidance only to those customers who are up-to-date with payments on maturity and who continue to make payments, though some suggested that firms should have discretion if there was only a small payment shortfall. Some groups that represent consumers, disagreed. They suggested we include all customers with arrears within the scope of the guidance, provided it was in the borrower's best interests.

3.12 Consumers and groups that represent consumers were generally supportive of our guidance and they requested that we keep our guidance under review and extend it if needed. A few such respondents asked us to go further and introduce a wider ban on repossessions for capital repayment mortgages, as well as interest-only and part-and-part mortgages which matured before 20 March 2020. A few firms asked us to extend the guidance to give customers whose mortgage expires towards the end of the 12-month period the same level of support as customers whose mortgages expired at the start of the guidance. A few such respondents asked us to conduct a review into fair treatment of interest-only customers, and review our Finalised Guidance (FG13/07) on how firms should deal fairly with interest-only mortgage customers who risk being unable to repay their loan.

3.13 One firm raised concerns about differential treatment of customers whose mortgage matured before 20 March 2020. One firm asked us to extend the guidance so that all customers are able to defer repayment of their capital for at least 12 months. One asked about our expectations regarding customers whose loans mature close to the end of the guidance.

3.14 A few firms asked for clarity about the prudential treatment of loans where borrowers have chosen to delay repayment of the capital under this guidance as these loans would usually be treated as past due.

Our response

3.15 We propose keeping this guidance as a consumer-exercised option for all eligible borrowers who choose to take advantage of it. If a borrower chooses to take advantage of this guidance then a firm must allow them to. This gives borrowers who want it certainty and breathing space until 31 October 2021, and protection against repossession if they are not able to repay the capital.

3.16 Firms should make the risks of delaying capital repayment clear to borrowers, for example that property prices may drop between now and 31 October 2021. They should also explain that it is in the customer's interest to repay now if they can as this will save them paying additional interest payments each month, and that ultimately any decision to delay is for the customer to make. To take advantage of this guidance the

customer will have to make an active choice to delay payment. Firms should also make it clear that customers can repay at any time and should do so as soon as they can, rather than waiting until 31 October 2021. We also encourage firms to maintain regular contact with their borrowers regarding loan repayment as set out in FG13/07 – Dealing fairly with interest-only mortgage customers who risk being unable to repay their loan. Borrowers may well benefit from engaging with their lender during any period they choose to delay capital repayment, and the guidance is not intended to prevent lenders contacting them.

3.17 The guidance explains that these communications should happen promptly, recognising the particular importance of informing borrowers with an imminent (or overdue) decision about capital repayment. When the maturity date is further away, for example in 2021, the firm will want to ensure that borrowers receive information about the option of delaying capital repayment in good time. As the option to delay capital repayment under the guidance expires on 31 October 2021 firms will want to keep their communications with borrowers under review. The nature and scale of the risks that should be explained to borrowers will change the shorter the period of delay.

3.18 We understand firms' concerns regarding retaining borrowers on an expiring fixed rate or other incentivised rate. We are clear that borrowers should not be penalised for making use of this guidance to delay capital repayment, and firms cannot charge a premium rate over and above the rate that would otherwise apply under the mortgage contract. The guidance should not prevent any mortgage from operating in line with existing contractual provisions for the applicable interest rate at maturity.

3.19 We agree that we should exclude bridging loans due to their short-term nature and higher interest rates. It is unlikely to be in a borrower's best interest to continue to pay interest for an extended period.

3.20 We confirm, however, that high net worth consumers remain within the scope of this guidance as they may be at risk of harm if current market conditions affect their ability to realise their repayment strategy. We can confirm the guidance only applies to regulated mortgage contracts, and not unregulated buy-to-let mortgages or MCD Article 3(1)(b) loans.

3.21 We do not intend to prescribe whether or how firms should contractually reflect the delay in repaying the capital. If a firm chooses to make a formal contract variation the standard MCOB requirements for such variations would apply.

3.22 Where borrowers are not up-to-date with payments we consider they are better served by our current requirements for a lender to carry out an individualised assessment about what course may best help a consumer to recover their position as set out in FG13/07.

3.23 Our proposals seek to reduce harm from the coronavirus pandemic and as a result we intend for the guidance to only cover mortgages that have matured on or since 20 March 2020.

3.24 However, firms can choose to offer a delay in capital repayment to borrowers whose mortgages have matured before this date – as well as to those in arrears, where they consider this to be appropriate.

3.25 We consider that due to the economic implications and uncertainty of the crisis a 12-month period is a reasonable period for the guidance to be in place. However, we will keep the situation under review and may extend this period if we feel this is in the best interest of borrowers. This guidance aims to help customers whose repayment strategies have been affected by the pandemic. So, we will not be extending the scope of the guidance to include all matured interest-only and part-and-part mortgages.

3.26 Respondents asked for clarification of the prudential and accounting implications of the proposal that firms should permit borrowers to delay the repayment of the capital on interest-only and part-and-part mortgages until 31 October 2021, where borrowers are (and remain) up-to-date with payments. The FCA has worked closely with the Prudential Regulation Authority (PRA) in considering this point.

3.27 Consistent with the requirements of the Capital Requirements Regulation (CRR), firms would need to consider whether any delay in capital repayment in accordance with the terms of the FCA guidance triggers the counting of days past due under CRR Article 178, 1(b). The PRA expects that allowing borrowers to delay the repayment of capital on their mortgages in accordance with the terms of the FCA guidance should not automatically result in the borrower being considered unlikely to pay under the CRR as there is no expectation under this FCA guidance that the firm investigates the borrower's individual financial circumstances before the measure is agreed. However, the PRA expects that firms will need to use all the information they have on the borrower's individual circumstances, including information about the intended repayment vehicle, to consider whether there are any indicators of unlikeliness to pay under CRR Article 178.

3.28 Similarly, allowing a delay to capital repayment under this FCA guidance does not on its own automatically result in a loan being regarded as having suffered a significant increase in credit risk (SICR) or being credit-impaired for expected credit loss accounting (ECL) under International Financial Reporting Standard 9 (IFRS 9). Again, firms will need to use all the information they have on the borrower's individual circumstances, including information about the intended repayment vehicle, to consider whether there are any indicators that the mortgage has suffered a SICR or became credit-impaired under IFRS 9. Where firms continue to have limited borrower-specific information to make judgments on an individual borrower-basis, the guidance in the PRA's June letter on a framework for making holistic assessments of loans for indicators of SICR or credit impairment will be relevant for making that judgment.

3.29 We consider this clarification to be consistent with IFRS and CRR. However, we also recognise it is the responsibility of firms to satisfy themselves that they have prepared their annual and interim financial reports in accordance with the applicable reporting frameworks and for auditors to reach their own audit or review conclusions about those reports. Similarly, it is for firms to ensure they comply with the requirements of CRR.

3.30 If firms have specific concerns about this guidance once it comes into force they should discuss this with their supervisory contact.

Cost benefit analysis

Consultation question

Q8: Do you have any comments on our cost benefit analysis on the proposed guidance on interest-only and part-and-part mortgages?

Feedback received

3.31 A number of respondents gave feedback on our cost benefit analysis. One group that represents consumers suggested we should have conducted analysis on other possible interventions, and another group that represents consumers requested further detail on why we believed this guidance should be in place for 12 months.

3.32 One trade association and a firm noted that there was no guarantee that the housing or financial markets will have significantly improved when this temporary guidance comes to an end. One trade association said that the housing market has picked up much more quickly than had been predicted, and so borrowers using the guidance may be worse off if they delayed sales of their property.

3.33 A few firms and a trade association stated that lenders' capital costs may be higher than those outlined in the CBA, especially if granting a further term to enable repayment will be classed as receiving forbearance. A few firms also noted that our estimated compliance and administration costs were too low.

Our response

3.34 Our reasoning regarding the length of time this temporary guidance is in place is outlined earlier in this chapter, as are our views regarding the capital treatment of loans where borrowers have chosen to defer payment of the capital using this guidance.

3.35 We are unable to predict how the housing market will develop over the period of the guidance. Our guidance emphasises that borrowers should repay when they can and, therefore, a relatively strong housing market will likely lead to less use of the guidance. This would reduce both the costs and benefits of our guidance.

3.36 The cost benefit analysis assesses the impact of the guidance relative to what would happen absent our guidance (our estimated counterfactual, or baseline). As the baseline includes the impact of coronavirus on the mortgages for which this guidance applies, we might expect costs for firms dealing with maturing interest-only mortgages regardless of the guidance. These costs include customer contact costs and provisioning of capital due to the delay in mortgage repayment. The CBA does not attempt to estimate these costs but only the additional ones that arise from the guidance.

3.37 FSMA mandates the provision of a cost benefit analysis for new rules but not for guidance. It is our policy to produce a cost benefit analysis for general guidance about rules if a high-level assessment of the impact of the proposal identifies an element of novelty which may be in effect prescriptive or prohibitive such that significant costs may be incurred. While we did not propose general guidance in the CP (as it is not intended to have continuing effect), we considered for this proposed guidance it was appropriate to produce a CBA, because of its medium-term and prescriptive nature.

3.38 The guidance published in this PS does not, in our view, differ significantly from the consultation draft. So, we do not consider that a new or revised cost benefit analysis is necessary.

4 Feedback and our response: Wider comments

4.1 In addition to the feedback on our proposed changes and guidance, we received responses from consumers and groups that represent consumers which raised wider issues, including the treatment of mortgage prisoners. We discuss these responses in this chapter.

4.2 Some respondents, including some consumers, and a few groups that represent consumers, called for us to take further action to help mortgage prisoners. This included an investigation into interest rates, a cap on SVRs and a review of our guidance on interest-only mortgages.

4.3 One group that represents consumers asked us to conduct a specific investigation into the condition of the wider mortgage market in Northern Ireland.

Cap on SVRs

4.4 In our Statement on mortgage prisoners, published in July, we set out our analysis that showed that the 55,000 borrowers with inactive firms who have characteristics that would make it difficult for them to switch (but are up-to-date with payments) are paying on average around 0.4 percentage points more than similar borrowers with active lenders who are now on a reversion rate. This means that these borrowers with inactive firms are paying rates that are broadly in line with the price in the active market, bearing in mind their risk and loan characteristics.

4.5 We understand the concerns of mortgage prisoners with inactive firms who are currently unable to switch to a new deal as they do not meet the risk appetite of lenders. We also set out in the Statement on mortgage prisoners that before we would consider intervening in any market with a price cap, we would need to be confident such an intervention would be the most proportionate and effective way of tackling that harm. We would have a range of complex considerations that we would need to work through. This would include the scope of any price cap and the extent to which it would affect those customers not benefitting from any cap, the extent of impact on firms' business models and pricing approaches and in some cases their viability, depending on the level at which any cap could be set. We would also need to consider any further unintended consequences of a price cap. In addition, we would want to understand how the interventions we have set out in our Statement on mortgage prisoners and this PS ultimately affect mortgage prisoners.

The regulatory perimeter

4.6 Several responses raised concerns that the boundary of regulated activities (known as the perimeter) could affect the fair treatment of borrowers whose mortgages are owned by an unregulated entity, and they called for an extension of the perimeter.

They also raised concerns that that where mortgages are sold to unregulated entities, borrowers may face an additional worry that they might see a reduction in their protection compared with borrowers whose mortgages are held by regulated lenders. There were some requests for a ban on sales of mortgages to unregulated entities.

4.7 The regulatory framework does not prohibit books of mortgages being sold by regulated lenders to purchasers that are not authorised for lending (unregulated entities) and sit beyond the regulatory perimeter. The administration of these mortgages must be undertaken by an authorised (regulated) firm, with unregulated entities appointing firms known as mortgage administrators. The perimeter and any changes to it are a matter for the Treasury and Parliament.

4.8 As outlined in our Statement on mortgage prisoners, there are some cases where an extension of the perimeter would give us regulatory reach or improve our reach. In practice, we have found that currently, in the majority of cases, where books have been sold to unregulated entities they have delegated key decision-making responsibilities on interest rate changes and forbearance to regulated firms. Further details on our view on this can be found in our Statement on mortgage prisoners.

Availability of switching options

4.9 A few responses raised concerns about the delayed implementation of our rule changes to remove potential barriers to borrowers switching to a more affordable mortgage (the modified affordability assessment). Some respondents also called for us to do more to help borrowers switch, such as by further relaxing our affordability rules or requiring firms to lend to consumers.

4.10 As we noted in the CP, as a result of the coronavirus pandemic, lenders had reported in the Spring that they would be unable to offer a range of switching options or have processes and systems in place to support remortgaging under our amended rules as quickly as anticipated. We are pleased to see that some lenders have now started to offer some of these solutions, and will continue to work with our Implementation Group on the further availability of switching options. Borrowers who are not up-to-date with payments are not eligible for the modified affordability assessment. It is important that borrowers who are not up-to-date with payments are treated fairly and our rules in MCOB 13 set out how we expect firms to do this. Firms should explore all relevant options for repaying the payment shortfall with these borrowers. This also applies to borrowers with unregulated entities as these entities have to appoint a regulated administrator who is required to comply with MCOB 13.

4.11 We cannot require firms to lend to 'mortgage prisoners' or to any other borrowers. Lending is a commercial decision, and some borrowers have circumstances that are outside the risk appetite of many lenders.

Other sources of help for borrowers in difficulties

4.12 We are especially grateful for the responses received from individual consumers. Some of these talked about borrowers' concerns with regulated firms or their individual circumstances.

4.13 The Financial Services and Markets Act 2000 does not give us the mandate to intervene in or investigate individual complaints against regulated firms on behalf of the public. If consumers feel that they have been treated unfairly, then they can raise a complaint with the firm. If they are not satisfied with the firm's response, they can refer their complaint to the Financial Ombudsman Service (the ombudsman service). The ombudsman service provides a dispute resolution service to consumers free of charge. Further information about the ombudsman service and information on how to raise a complaint can be found on the ombudsman service website.

4.14 The Money and Pensions Service (MaPS), provides easily accessible information to help borrowers make financial decisions and provides access to free debt advice for those that need it. All borrowers can access this information and these services. Information on how to contact MaPS can be found on MAPS website.

4.15 In addition, we have worked with MaPS to create specific online information for mortgage prisoners and a dedicated phone service as a key source of information and advice for borrowers with inactive firms. For those borrowers likely to have switching options, these MaPS resources signpost to specific brokers that will be able to help. For those borrowers who are not eligible for the modified affordability assessment (eg where they are not up-to-date with payments), these MaPS resources can help them find other sources of advice and support.

Annex 1
List of non-confidential respondents

All Party Parliamentary Group on Mortgage Prisoners

Association of Mortgage Intermediaries

Building Societies Association

Computershare

Financial Services Consumer Panel

Kensington Mortgage Company

Money Advice Trust

Money and Pensions Service (MaPS)

Money Saving Expert

The Co-operative Bank

The Consumer Council of Northern Ireland

UK Finance

UK Mortgage Prisoner Action Group

We have also received responses from 7 other firms and industry organisations which have asked for their responses to be treated as confidential. We have also received responses from 24 individuals, which we treat as confidential.

Annex 2
Abbreviations used in this paper

CP	Consultation Paper
CBA	Cost Benefit Analysis
MaPS	Money and Pensions Service
MCOB	the Mortgages and Home Finance: Conduct of Business Sourcebook (FCA Handbook)
MMS	Mortgage Market Study
Part and part mortgage	a mortgage which is part capital repayment and part interest only
PS	Policy Statement
SVR	Standard Variable Rate

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Appendix 1
Final Guidance

1. This guidance applies to mortgage lenders and mortgage administrators.

2. This guidance applies in the exceptional circumstances arising out of coronavirus (Covid-19) and its impact on the financial situation of customers with interest-only and part-and-part mortgages.

3. This guidance comes into force on 31 October 2020 and expires on 31 October 2021. We will keep the guidance under review.

4. This guidance builds on Principle 6 ('A firm must pay due regard to the interests of its customers and treat them fairly'), Principle 7 ('A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading') and MCOB 2.5A.1R ('A firm must act honestly, fairly and professionally in accordance with the best interests of its customer'). It is potentially relevant to enforcement cases and the FCA may take it into account when considering whether it could reasonably have been understood or predicted at the time that the conduct in question fell below the standards required by Principle 6, Principle 7 and MCOB 2.5A.1R. A firm is likely to contravene these rules if it acts in a manner inconsistent with this guidance.

5. Where there has been an assignment of the rights under the mortgage contract to a non-authorised person, the person must still comply with general consumer protection law including the Consumer Protection from Unfair Trading Regulations 2008. A commercial practice may be unfair under those Regulations if (among other things) it contravenes the requirements of professional diligence. Professional diligence means the standard of special skill and care which a trader may reasonably be expected to exercise towards consumers. The guidance below is intended to describe the standards of skill and care we consider may reasonably be expected of lenders in the mortgages market in the current exceptional circumstances of coronavirus. If, therefore, a lender does not follow this guidance, that could call into question whether it is meeting the requirements of the 2008 Regulations, even if the lender is not regulated under FSMA.

6. If you have any questions or concerns about this guidance, contact us.

Treatment of interest-only and part-and-part mortgage customers

7. This guidance applies in respect of interest-only and part-and-part mortgages (ie a mortgage which is part capital repayment and part interest-only) with maturity dates between 20 March 2020 and 31 October 2021 ('relevant mortgages') and where the capital repayment is still outstanding. This guidance applies only to regulated mortgage contracts. It does not apply where such a mortgage satisfies the Handbook Glossary definition of a bridging loan.

8. This guidance allows firms to support borrowers at a time when they will be facing ongoing uncertainty and worry regarding their ability to repay the capital on their mortgage. Customers with relevant mortgages may find that their repayment strategy, or ability to form such a strategy, has been impacted by the unique combination of challenges presented by coronavirus and the associated steps taken to contain the virus (for example, short to medium-term disruption in the property markets resulting from government lockdown measures). While the long-term economic effects of coronavirus are yet to be determined, the period in which there could be market impact on customers' repayment strategies may be temporary.

9. Therefore, where a customer has a relevant mortgage and is up-to-date with their mortgage payments, firms should allow them the flexibility to choose to delay the repayment of any capital on their mortgage until no later than 31 October 2021.

10. A customer that has made use of a payment deferral, granted under our temporary guidance on mortgages and coronavirus, is considered as being up-to-date with mortgage payments. These payment deferral arrangements may provide for capitalisation over the remaining term of the mortgage or a reasonable extension of the term alongside capitalisation (unless this would take the customer past retirement).

11. If a customer fails to make interest payments after agreeing a delay to the capital repayment, except in accordance with a payment deferral agreed under the guidance 'Mortgages and Coronavirus: Payment Deferral Guidance'[1],this guidance will no longer apply. However, firms are reminded of our rules and the guidance in MCOB 13 and the more general obligation to treat customers fairly under Principle 6 (and can continue to offer flexibility to customers who are not up-to-date with payments, where this is consistent with their best interests).

12. Firms should not charge any additional fees as a condition of offering a delay to the capital repayment. Interest may continue to be charged at the rate charged pre-maturity, at the rate charged at maturity, or lower, in accordance with the relevant contractual terms. Where this rate is the firm's standard variable rate, payments may be varied in accordance with changes to this rate.

Part-and-part customers – specific issues

13. Firms should allow eligible part-and-part customers who will have repaid the capital on the capital repayment part of their mortgage upon maturity, to:

- make interest payments on the interest-only part of their mortgage only; or
- make payments of both interest and capital on the outstanding interest-only part of their mortgage.

14. If an eligible part-and-part customer has not repaid the capital part of their mortgage because of a payment deferral, the firm should reach agreement with the customer on the payment of the outstanding capital amount and any deferred interest. For example, the amount could:

1 Underlined wording added on 16 November 2020 with effect from 20 November 2020

- be repaid separately to the interest on the interest-only part of the mortgage; or
- be capitalised to the interest-only part of the mortgage.

Implementation of this guidance

15. Firms should promptly contact all customers eligible to take advantage of the flexibility offered by the guidance, prioritising those whose mortgage will shortly mature or has already matured. Where the mortgage has yet to mature this contact should be made a reasonable period in advance.

16. Where firms have agreed that customers can delay repayment of their mortgage prior to this guidance coming into force, firms do not need to contact them again under this guidance, provided customers were given the option to delay the repayment until 31 October 2021.

17. Before arranging the delay to the capital repayment, firms should give eligible customers appropriate information and support to help the customer understand the implications of delaying the capital repayment, including the continuing obligation to make regular interest payments for the period of the delay to the capital repayment.

18. This should include:

- providing personalised information on the level of interest payment they will need to maintain; and
- making clear to customers that:

  a. while the decision on whether to defer the repayment of capital is ultimately theirs it is likely to be in their best interests to repay;
  b. choosing to delay repayment of capital could expose the customer to further risk, for example should there be further market disruption at the time at which capital falls to be repaid; and
  c. the delay to the capital repayment will only apply while the customer continues to make interest payments.

Credit Reference Agency reporting

19. We understand that industry practice is to report on past-term customers who continue to make interest payments as up-to-date, with arrears potentially reported where payments are not made. For customers who continue to make interest payments in accordance with this guidance we would expect payments to be reported in this way, with no other negative reporting to credit files (eg arrangement flag/status).

Appendix 2
Made rules (legal instrument)

MORTGAGES (INTRA-GROUP SWITCHING) INSTRUMENT 2020

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the “Act”):

(1) section 137A (General rule-making power); and
(2) section 137T (General supplementary powers).

B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 23 October 2020.

Amendments to the Handbook

D. The Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Mortgages (Intra-Group Switching) Instrument 2020.

By order of the Board
22 October 2020

Annex

Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

In this Annex, underlining indicates new text and striking through indicates deleted text.

11 Responsible lending, and responsible financing of home purchase plans

…

11.6 Responsible lending and financing

…

11.6.3 R (1) *MCOB* 11.6.2R does not apply to:

(a) entering into a new *regulated mortgage contract* or *home purchase plan* as a replacement for an existing *regulated mortgage contract* or *home purchase plan* between the *customer* and the *firm* (either as the original *mortgage lender* or *home purchase provider* or as the transferee of the existing contract), whether or not the new contract relates to the same property; ~~or~~

(aa) entering into a new *regulated mortgage contract* as a replacement for an existing *regulated mortgage contract*, whether or not the new contract relates to the same property, where the original *mortgage lender* (or, where the existing contract has been transferred, the transferee):

(i) is not entering into *regulated mortgage contracts* with new *customers*; and

(ii) is in the same *group* as the *mortgage lender* under the new contract; or

…

Pub ref: 007358

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12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
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