FINANCIAL CONDUCT AUTHORITY

Switching in the mortgage market – an update

Currently, most mortgage products sold in the UK comprise a short-term introductory deal (often at a fixed interest rate) after which the rate changes to another (reversion) rate, such as a Standard Variable Rate (SVR) or a rate linked to a benchmark such as the Bank of England Base rate. Moving to a reversion rate can mean an increase in interest rate and mortgage payments. At this point it may be in a borrower's interest to switch to a new product either with their existing or a new lender. If the market works well, borrowers who would benefit from switching can and do switch. We therefore monitor levels of switching in the mortgage market.

Executive Summary

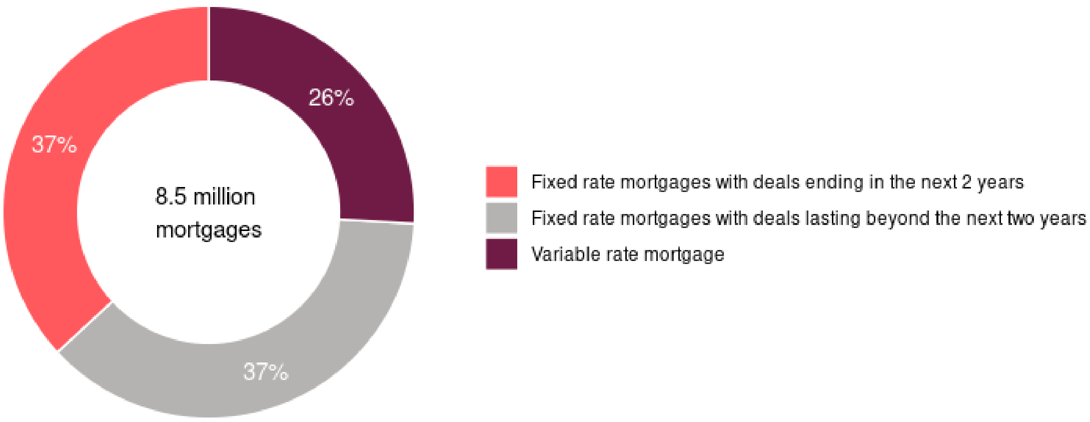
- Our most recent analysis, using data from the second half of 2021 shows that 6.3m mortgages (74%) are on fixed rates, typically fixed for between 2 and 5 years. Of the 2.2m (26%) on variable rates, around half are on discounted variable or tracker rates and half are on reversion rates.
- The number of mortgage borrowers not switching their mortgage deal when they could save money by doing so has declined significantly since 2016.
- We estimate that borrowers of around 370,000 mortgages could save an average of £1,240pa for 2 years by switching to a 2-year fixed rate with their existing lender.
- Those who we estimate would save would not all save equally. We estimate that around 110,000 would save less than £500 a year for 2 years, 110,000 would save between £500-£1,000 and 150,000 would save over £1,000 a year for 2 years.
- Not all borrowers on a reversion rate who can switch, would save money by switching (190,000).
- Around half of mortgages currently arranged on fixed rates expire in the next two years.
- Given the rising cost of living, it's important that borrowers consider their options and switch if they can where it meets their needs and circumstances and saves them money. Lenders and mortgage intermediaries should support customers to do this.
- We recently asked lenders to consider what more they can do to encourage mortgage borrowers to think about switching to a less costly option where that is available.
- We do not see the same poor pricing practices that used to be prevalent in the general insurance markets, where pricing was opaque and loyal customers could face dramatic price increases over time as a result of price walking.
- We will continue to monitor the market, particularly given the impact on borrowers of increasing mortgage rates and the rising cost of living and consider what further steps we may need to take.

Here, we set out more detail on our recent findings and the actions we think borrowers and lenders should take.

The impact of the rising cost of living

Mortgage borrowers, including those who do actively switch their mortgage, face increasing pressure from the rising cost of living. Around half of mortgages currently arranged on fixed rates expire in the next two years.

Figure 1: 37% of borrowers are protected from interest rate rises in the next 2 years



Many mortgage borrowers have paid comparatively low interest rates in recent years, on both fixed and variable rates, and so most will likely face increasing mortgage costs as base rates and the cost of new fixed or other incentivised deals increase. It is therefore more important than ever that mortgage borrowers are aware of their options and take action to switch where they can where it suits their needs and circumstances, and where it can save them money.

The actions mortgage borrowers should take

Mortgage borrowers on a reversion rate, and those coming to the end of a fixed rate (or other incentivised deal) should consider whether they may be able to switch their mortgage to one with a lower rate which meets their needs and circumstances and which will save them money (after any fees and charges they may pay for their new mortgage).

Borrowers should:

- ensure they understand their options including whether they can switch to a new mortgage with their existing lender or with a new lender.
- consider whether switching their mortgage to one with a lower rate (or a fixed rate) meets their needs and circumstances and may save them money.
- engage with their lender or a mortgage broker if they need help to switch or help to determine whether switching to a new deal is right for them.

See our webpage on dealing with the financial impact of rising costs of living.

Our expectations of lenders

Many firms, and brokers, contact borrowers to encourage them to switch when they come to the end of their fixed or introductory deal.

- However, lenders should not be complacent given the rising cost of living and the significant impact this is having on borrowers. We recently wrote to the Chief Executives of all mortgage lenders and administrators to set out our expectations. We asked firms to consider what more they can do to encourage mortgage borrowers to think about switching to a less costly option where that is available.
- The Consumer Duty will require all firms to focus on customer outcomes. As well as ensuring individual communications are fair, clear and not misleading, firms will need to consider their overall approach to communicating information to make sure they equip consumers to make effective, timely and properly informed decisions and to monitor the outcomes borrowers receive. Whilst the Consumer Duty is not yet in force, firms shouldn't wait to apply these requirements and should look for opportunities to support consumers to make the decisions they need to make

- Firms should treat those who cannot switch fairly and support those in financial difficulties. Our recent letter confirms our expectations.

The actions we will we take

We will:

- Continue to track the number of borrowers who are not switching when it would save them money if they were to do so.
- Consider the impact on consumers of increased costs where cheaper legacy deals are replaced with more expensive ones in a rising interest rate environment.
- Continue to engage industry to discuss the actions they can take to consider what more they can do to encourage mortgage borrowers to think about switching to a less costly option where that is available.

Our priority is to ensure that markets provide fair outcomes for all borrowers including longstanding and vulnerable consumers.

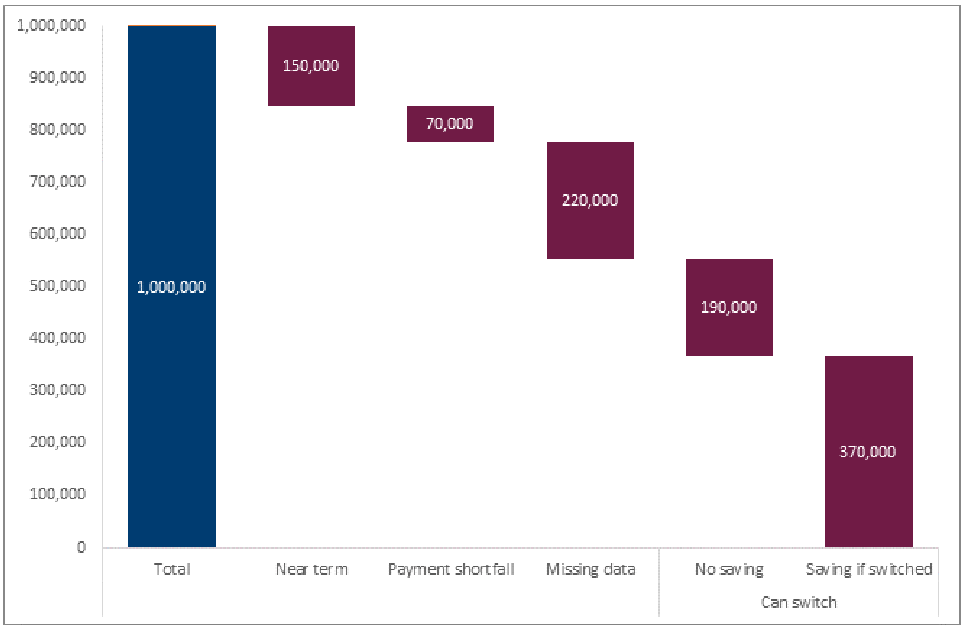
Further detail on our findings

Our latest analysis shows that the number of mortgages on a reversion rate has fallen significantly since we looked at this as part of the Mortgages Market Study (MMS). While we do not have access to identical data used for the MMS, we find that the number of mortgage borrowers who do not switch when they can, and when we estimate it would save them money to do so, has also fallen significantly since 2016. We look at mortgages on a reversion rate for 6 months or more because it is a way of identifying borrowers who are most likely to be inactive. We do not include lifetime or second charge mortgages.

We found that 1 million mortgages had been on a reversion rate for at least 6 months in the second half of 2021. We estimate that:

- 370,000 (4% of borrowers) could save an average of £1,240pa for 2 years by switching to a 2-year fixed rate, and that
- 190,000 appear able to switch but would not save money by switching, for example because they are paying a lower rate
- 150,000 are near the end of their mortgage term and 70,000 are in payment shortfall. In addition, we do not have enough data to assess if 220,000 could save money by switching.

Figure 2: A summary of the 1 million mortgages on a reversion rate for at least 6 months



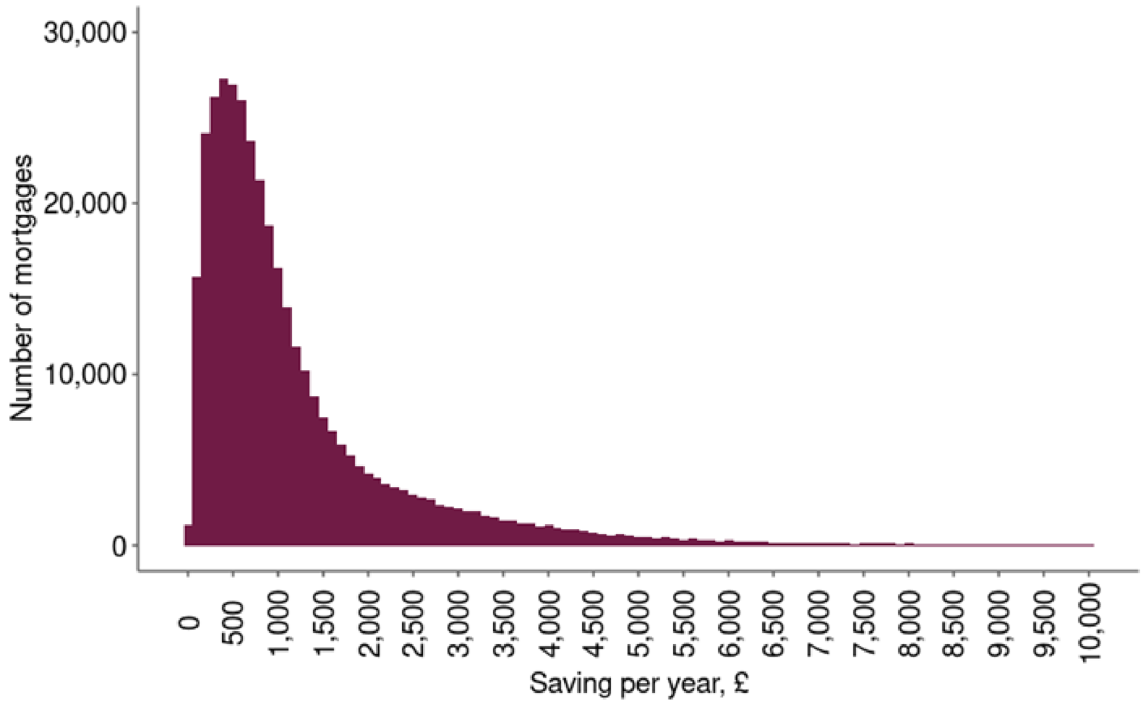
This data shows a significant decrease from over 2 million residential mortgages (25% of mortgages at the time) reported in the MMS as on a reversion rate for six months or more in 2016. It also shows a significant decrease in the number of borrowers who we previously estimated, using a different methodology, could switch and who could save money by switching but did not do so:

- In 2016 we estimated 800,000 (10% of mortgage borrowers) could save an average of £1,000pa for 2 years (and £100pa thereafter) by switching to a 2-year fixed rate, and that,
- 790,000 could switch but would not save money from switching.
- 140,000 were near the end of their mortgage term and 100,000 were in arrears. We did not have enough data to assess if 160,000 could save money by switching.

Not all borrowers benefit from switching and some do not want to switch

Some borrowers are paying relatively low rates for their loan and personal characteristics, and would not save money by switching. And those who we estimate would save would not all save equally. As Figure 3 shows, some borrowers, such as those with large mortgages, could save significant amounts from switching. Others, including those with a repayment mortgage nearing the end of its term, would save much less than the average. The median saving for the 370,000 we estimate would save from switching is £810pa, so half would save less than this and half would save more.

Figure 3: Potential annual savings for 370,000 we estimate can save money by switching



Some borrowers will decide not to switch because staying on the reversion rate suits their needs and circumstances. For example, they may be thinking about moving home or anticipating another future life event that will mean they would like the flexibility to repay their mortgage at will without paying an early repayment charge. Other borrowers may not value the potential savings over the flexibility to repay without penalty. Paying a reversion rate does not automatically mean a consumer is experiencing harm or paying a 'loyalty penalty'.

In March 2020, we published research which explored why some consumers do not switch their mortgage even when they could save money by doing so. This research is relevant to the way firms communicate with consumers to help support and equip them to make effective, timely and properly informed decisions.

- Mortgage switching research report
- Occasional Paper 54 on the characteristics of consumers who do not switch
- Occasional Paper 55 on brand loyalty in the mortgage market

The above research found the factors that contribute to the decision not to switch include a lack of time, a fear of the application process and, for many, relative contentment with their current lender or deal.

The research also suggests that consumers could become better engaged with the switching process if given the right information at the right time. Firms should consider this research which found that consumers needed to engage with the switching process, see the case for switching and get enough information without being overwhelmed.

Some borrowers cannot switch

Our analysis considers whether borrowers who can switch would benefit from switching. Borrowers who are in financial difficulty cannot usually switch because most lenders do not offer new deals to anyone who is not up to date with their payments. Firms should however offer tailored support to borrowers in financial difficulty. Our recent Dear CEO letter sets out our expectations of firms when supporting these borrowers.

Some other borrowers have a mortgage with firms that do not offer new deals. If these borrowers do not meet the risk appetite of other lenders they cannot switch even if they are up to date with payments. In October 2019, we changed our rules to allow lenders to use a modified affordability assessment for borrowers who were up to date with payments to enable them to switch to a more affordable mortgage. In October 2020, we changed our rules so that active lenders no longer have to make an affordability assessment when they offer a new deal to borrowers in closed mortgage books of a lender in the same financial group. In November 2021 we published our Mortgage Prisoners Review to help Government and Industry to consider if there are any practical and proportionate solutions to help these borrowers switch to an active lender.

Finally, borrowers with a repayment mortgage with a term of less than 24 months remaining or a balance of less than £10,000 cannot usually switch to a new deal but the financial benefits of switching would be very small even if they could switch.

The case for further regulatory intervention is not currently justified

The number of borrowers who can switch but do not switch when it may save them money to do so is very low. Most customers switch regularly to obtain the best deal. Others may benefit from paying a reversion rate or choose to pay more for the flexibility it provides.

There is little evidence of significant harm caused by a 'loyalty penalty' in the current mortgage market. The drivers of mortgage pricing are very different to what we found in the General Insurance (GI) market. Incentivised deals have different terms and conditions and should not be compared with reversion rates on rate alone. We think pricing is generally transparent, and the structure of a mortgage product is fairly well understood by consumers evidenced by the extent of switching. Borrowers need to consider the trade-offs when considering what is appropriate for their individual needs and circumstances.

But we are not complacent and want to continue to encourage those that might benefit from switching to do so. We will also continue to work with lenders to ensure they treat all customers fairly, focusing on those who are in financial difficulty or cannot otherwise switch, particularly given the potential risks from the rising cost of living.

We will continue to monitor the market and if the situation changes materially, or we see evidence of practices similar to that previously seen in the GI market, we will consider what further steps we may need to take.

Background

After publishing the MMS in May 2018, we worked quickly with mortgage lenders and in July 2018 active lenders, covering around 97% of the active market (or about 8 million mortgages), agreed to give existing residential mortgage customers on a reversion rate the option to move to a new deal, if they meet certain criteria such as being up to date with payments. This means that in most cases, borrowers up to date with payments can obtain a new deal with their existing lender without having to demonstrate affordability.

The Citizens Advice's 2018 super-complaint to the Competition and Markets Authority (CMA) raised concerns about the perceived 'loyalty penalty' where some longstanding consumers pay more than existing consumers in a number of markets including mortgages, cash savings and home insurance.

Citizens Advice defines the 'loyalty penalty' as 'the difference between what loyal and new consumers pay *for the same service'.* We acted to address the loyalty penalty in the general insurance market so that Insurers are now required to offer renewing customers a price that is no higher than they would pay as a new customer. The mortgage market is different. Fixed, or otherwise incentivised, rates have different terms and conditions, usually with significant early repayment charges – and the lowest rates often come with large fees. Paying a reversion rate may be cheaper than a new deal and appropriate for an individual borrower's needs and circumstances.