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Harriett Baldwin MP
Chair
Treasury Select Committee
House of Commons
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10 November 2023

Dear Harriett,

<u>Re: Update on mortgage borrowers in closed mortgage books</u>

Further to my letter of 31 August,[1] I am writing to provide updated estimates on the numbers and characteristics of mortgage borrowers in closed books or with inactive lenders. This updates several data points from our 2021 Mortgage Prisoner Review.[2]

There is detailed analysis in a supplementary note attached, with the key findings (based on our loan performance data up until June 2023) summarised below:

- The number of borrowers in closed books continues to fall and since June 2021 has reduced by over 26,000 accounts. There are now 166,880 mortgages in closed books, representing 2% of all outstanding regulated mortgages. The median closed book loan is £83,000 (active lenders £120,000) with a median loan to value of 42% (active lenders 46% LTV).

- Since the beginning of 2021, 10,992 closed book borrowers have remortgaged to an active lender. Most have made significant monthly savings by locking into a fixed rate. Of those who remortgaged, 4,903 (44.6%) had whole or part interest-only mortgages. Of these, 4,052 (82.6%) converted to a repayment mortgage.

- Of the total number of closed book borrowers, around 16,700, have a remaining term of less than 2 years and/or a balance less than £10,000. There are unlikely to be external switching solutions for these borrowers and even if there were, the costs of switching would most likely outweigh the benefits.

- Rising interest rates, alongside other financial pressures on households are leading to an increase in the number of closed book borrowers with a payment shortfall, with the percentage of mortgages in shortfall rising from 17.2% (34,000) in H1 2021 to 24.9% (41,600) in H1 2023. Repossession numbers have slightly increased in recent months but remain lower than in 2019. Borrowers who feel that their mortgage is no longer affordable should speak to their lender. They can also seek independent debt advice to understand the options available, including whether there are regional or local support schemes available.

[1] committees.parliament.uk/publications/41211/documents/202648/default/
[2] Mortgage_Prisoners_Review_CP576_FINAL.pdf (publishing.service.gov.uk)

- Regardless of the status of the lender (active or closed book/inactive) we can see limited difference in the levels of forbearance being provided. Our data shows that borrowers in arrears continue to receive long-term forbearance. The median time to repossession is currently 35 months for closed books and 36 months for active lenders.

As set out in my earlier letter, the FCA has done all that it can within its powers to ensure there are no regulatory barriers for borrowers in closed books to switch to a new lender. For example, in the event of firm failure, we have no powers to ensure mortgage books are sold to active lenders. Our focus is on making sure that regulated closed book owners and administrators meet the standards of support we expect for all borrowers in financial difficulty, which are the same for all mortgage firms.

We understand that Government and industry continue to consider further potential options for borrowers in closed books, and we will support them as their thinking develops. We will also continue to closely oversee firms' treatment of borrowers in closed books, to ensure they receive appropriate support for their circumstances and will continue to take action where there this is not the case.

Yours sincerely,

Nikhil Rathi

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Chief Executive

Supplementary closed book update note

The role of the FCA

We have removed regulatory barriers to allow borrowers in closed books to switch to an active lender. The rule changes allow active lenders to offer loans to borrowers with inactive firms without undertaking the standard affordability test, providing the new payments are more affordable. However, whether any switching options are offered will remain a commercial decision informed by a lender's risk appetite. Our regulatory powers do not allow us to force a firm to lend to borrowers outside of their risk appetite, for example to borrowers in arrears or with an interest-only mortgage where the borrower has no repayment plan in place. Some lenders do not offer interest-only mortgages and those that do will only offer low loan to value loans and borrowers also have to be able to evidence a credible repayment plan.

When we completed the 2021 Review, we did not identify any further regulatory solutions the FCA could deliver. This remains the case. We continue to support Government and the industry as they consider options to support some of these borrowers that need support.

We continue to closely monitor firms to make sure they provide all borrowers – in both closed and active books – with the support they need when they get into financial difficulty and will act as necessary to address harms we find. Our Principles and rules, and the associated guidance for firms on the fair treatment of vulnerable customers, help ensure fair outcomes for customers with characteristics of vulnerability.

Closed books and the Mortgage Charter

The Government's Mortgage Charter includes commitments to book and manage new fixed rates up to six months ahead of a current fixed rate expiring, take temporary reductions in repayments and not to repossess within one year of a borrower's first missed payment.[3] Over 90% of the active market has currently signed up to the Charter.

Closed book and inactive lenders cannot meet all the terms of the Government's Charter because they are unable to offer new deals to borrowers. However, several large, closed book and inactive lenders have made their customers aware they are observing the commitments they can deliver on, for example offering term extensions, temporary switches to interest-only and not forcing borrowers to leave their home in less than a year from their first missed payment.

Impact of new Consumer Duty

The mortgage market has been subject to regulation since October 2004. However, in the run up to the financial crisis in 2007 the market was characterised by poor lending practices that led to unaffordable mortgages, high levels of arrears and unfair treatment of borrowers. To prevent these poor practices from re-occurring, we significantly strengthened aspects of mortgage regulation in 2014 as part of the Mortgage Market Review.

The Consumer Duty is an additional standard to help us to prevent harm. It supplements these now long-established mortgage standards that have supported borrowers, particularly those in financial difficulty, for many years.

The Consumer Duty comes into effect for closed products, such as the mortgage accounts held by closed books or inactive firms, at the end of July 2024. Ahead of that date we are monitoring firms' implementation plans and continuing to supervise them against our current rules and guidance to ensure fair customer outcomes.

[3] https://www.gov.uk/government/publications/mortgage-charter/mortgage-charter

We expect all firms to act to deliver good outcomes for consumers and this also applies to closed books and inactive lenders. This means acting in good faith, avoiding causing foreseeable harm and supporting consumers in vulnerable circumstances. The Duty however does not give us powers to force inactive lenders to offer new deals or to make active lenders take on borrowers outside their risk appetite.

Where the owner of a mortgage book is unregulated and the regulated party is an administrator, the Duty applies in an appropriate and proportionate manner to the administrator's function. For example, where a regulated administrator has delegated responsibility for setting interest rates on a mortgage book owned by an unregulated lender, they should act in good faith when making any pricing decision.

Further analysis of the number and characteristics of mortgage borrowers in closed books or with inactive lenders

Snapshot of key changes since June 2021

(The Mortgage Prisoner Review was based on data up until June 2021.)

Key changes	H1 2021	H1 2023
Base rate	0.10%	5.25% (at August 2023)
Number of borrowers in closed books	195,000	166,886
Number of borrowers who have switched to active lenders	2,200	11,000
Interest-only borrowers %	53.5%	52.9%
Interest-only past maturity %	2.77%	3%
Payment shortfalls %	17.2% (34,000)	24.9% (41,600)

Higher interest rates

Since our 2021 Mortgage Prisoners Review the main change for all mortgages holders has been the impact of higher borrowing costs, primarily due to continued increases to the Bank of England base rate.[4] The base rate is currently 5.25%, in June 2021 it was 0.10%.

Higher interest rates will especially impact borrowers with variable rate mortgages – standard variable rates (SVRs), tracker rates and discounted rates. Around 96% of borrowers in closed books have variable rate mortgages. We know from our ongoing work that a number of borrowers in these closed books were already struggling to pay their mortgages in a much lower interest rate environment.

The median SVR (Standard Variable Rate) paid by closed book borrowers at the end of June 2023 was 8.3% compared to a median SVR of 7.49% with active lenders (see appendix 1 for a more detailed look at the range of current SVRs). As of 6 November, the median market wide SVR is 8.74% (source Moneyfacts)

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[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1036355/Mortgage_Prisoners_Review_CP576_FINAL.pdf

There are a number of reasons for the difference in the range of SVRs. Although lenders have mainly increased their SVRs to reflect base rate rises, lenders have firm-specific considerations to account for when setting their SVR. Some lenders have chosen to forgo or delay passing the full increase onto mortgage borrowers. Others, such as closed book/inactive lenders, many of whom are reliant on more expensive wholesale funding, will face other expenses and are exposed to other financial risks.

In H1 2021, a sustained low base rate meant that 95% of closed book mortgages were paying a lower interest rate than when the loan was first taken out. The impact of a much higher base rate means that at H1 2023, 86% of closed book borrowers are now paying a higher rate than at origination.

Switching to an active lender

When we published the 2021 Review, we estimated that around 66,000 closed book borrowers should be able to switch because they were likely to be within the credit risk appetite of active lenders.

11,000 borrowers in closed books have remortgaged since the Review and 81% switched to a fixed rate. Of the borrowers who remortgaged, 47% had interest-only mortgages and of these 82.5% converted to a repayment mortgage. 82% used the services of a mortgage broker.

In terms of the new mortgage deals obtained, our data shows that:

- the median mortgage value was £113,495
- the new median loan to income ratio was 2.26 (indicating good affordability)
- the median LTV was 55%
- the median interest rate paid pre-switch was 7.3%
- the median interest rate paid post-switch was 4.55%

However, we know there are characteristics of closed book borrowers that mean many fall outside active lenders' criteria and risk appetite. Closed book mortgages tend to have smaller outstanding balances, have shorter remaining terms, are more likely to be an interest-only mortgage and be held by older borrowers than those in active books.

	Median mortgage balance	**Median LTV**	**Median mortgage term**	**Median age of first borrower**	**Proportion interest-only**
Closed book	£83,000	42%	8yrs	54	53%
Active lender	£120,000	46%	18yrs	44	7.5%

This is to be expected given these closed books are in run off with no new lending. However, these characteristics can make it more difficult for some to remortgage to an active lender, and borrowers may have other factors that put them outside active lender criteria (e.g., employment status and income, proximity to retirement, expected retirement income and the existence of other debts).

Our data shows that of the total number of closed book borrowers, around 16,700 have a remaining term of less than 2 years and/or a balance less than £10,000. There are unlikely to be external switching solutions for these borrowers and even if there were, the costs of switching would most likely outweigh the benefits.

There are also unlikely to be switching solutions for the 41,600 borrowers in payment shortfall and this equally applies to borrowers with active lenders as typically new lenders will not lend to borrowers who are in current financial difficulties. Active lenders also do not generally offer internal product switches to borrowers in arrears.

Borrowers who have a past maturity interest-only mortgage (2,657 mortgages) also have limited switching options but may in some circumstances be able to take out a later life lending option such as a lifetime mortgage.

Past maturity interest-only borrowers

In 2007, interest-only mortgages accounted for a third of all mortgage sales and of these around 75% had no reported repayment strategy. Interest-only mortgages allowed borrowers to take our larger mortgages than they would have been able to afford on a repayment basis and in comparison to their incomes. Some borrowers in financial difficulty will also have been switched to interest-only as part of a forbearance strategy and may have had to remain on interest-only because moving back to a repayment mortgage would have been unaffordable.

Consequently around 53% of closed book mortgages are interest-only. Where borrowers are only paying the interest due on their mortgage, they are more exposed to increased nominal payments as rates rise. Borrowers with no repayment plan are also exposed to the risk of having to sell their homes to repay the interest-only loan at maturity.

Over the past decade we have put in place new rules and guidance for firms to make sure that interest-only borrowers are treated fairly, especially those at risk of not being able to repay the mortgage at the end of the term.[5] Our guidance is clear that we expect firms to work with borrowers to minimise the risk of the property having to be sold at the end of the term. Where the borrower can demonstrate affordability, lenders can extend the term into retirement or can provide the borrower with more time to make overpayments to reduce the debt, giving them more options to meet their housing needs at maturity. Where the borrower is already in arrears, we expect firms to give borrowers enough time to consider their options, such as selling the property.

There is now a slightly higher proportion of closed book interest-only mortgages reported as being past their maturity date compared to active lenders.

- 3% (2,657) of closed book mortgages are past maturity compared to 2.5% (13,051) of past maturity interest-only mortgages in active books.

However, 34% (916) of closed book interest-only past maturity mortgages are also in arrears of more than 2 months, compared to 15.6% (2,417) of similar accounts in arrears with active lenders. This indicates that closed book firms are applying a significant amount of forbearance to interest-only maturity borrowers, even where they are in arrears, potentially in recognition of the vulnerable circumstances of some of these consumers.

Payment shortfalls

The proportion of closed book accounts with a payment shortfall (of any amount) has increased from 17.2% (34,000) loans to 24.9% (41,600 loans). In contrast, the proportion of accounts in payment shortfall with active lenders has remained static over the same period. There are 179,200 accounts with a shortfall with active lenders (2.2% of all payment shortfalls). Of those, around 25% (45,000) are paying rates of 3% or lower and around 66% (118,330) are paying rates of 7% or less indicating that the level of interest rate is not the only reason for borrowers experiencing financial difficulties. As at the end of June 2023, in closed books 73% of accounts in shortfall were paying rates more than 7%. It should be noted that the data used to undertake this analysis does not include the impact of the base rate rises of 0.5% in June and 0.25% in August.

Repossessions

Repossession levels remain lower than they were before the pandemic, and this can be seen in the low number of repossessions since we undertook the 2021 Review.

[5] https://www.fca.org.uk/publication/finalised-guidance/fg13-07.pdf

In the 2.5 years between the start of H1 2021 and the end of H1 2023, there were 700 closed book repossessions (14% of the total number of repossessions during that period). Active lenders over the same period took possession of 4,200 properties. Although closed book mortgages only account for 2% of all outstanding mortgages, the higher proportion of possessions in the closed book population reflects the higher risk characteristics of many closed book loans and the higher incidence of payment shortfalls.

We have looked at the time taken from the first missed payments (arrears of 2 months or more) to repossession. Our current data shows little difference in the median time to repossession between active and closed book lenders (35 months for closed books and 36 months for active lenders).

Our rules are clear that firms should not start repossession action unless all reasonable attempts to resolve the position have failed – seeking possession should be a last resort. Our data indicates that firms are generally complying with our rules and that borrowers in financial difficulties continue to receive extensive levels of forbearance regardless of the status of their lender.

A lender can only repossess a borrower’s home if a court grants permission. A judge will hear the case and determine if the lender has acted in line with the expected standards and whether the homeowner has a defence. Our rules are reinforced through pre-action requirements in UK courts, providing borrowers with a further layer of protection.

However, while it is vital that borrowers are provided with support and assistance to help them to remain in their homes, delaying repossession where the mortgage is in an unrecoverable position can also cause harm and poor financial outcomes for the borrower where the overall debt is increasing, and equity is being eroded. In certain circumstances, a property sale may be the least-worst outcome for the affected customer.

Appendix 1

Range of current SVRs charged by range of different types of lenders

(Source: Moneyfacts and firms' own websites)

Lenders	Current SVR or reversion rate (as of 7 November 2023)
Mainstream	
HSBC	6.99%
Leeds Building Society	7.49%
Coventry Building Society	7.49%
Nationwide	7.99%
Co-op	8.12%
NatWest	8.24%
Santander UK	8.5%
LBG/Halifax	8.74%
Barclays	8.74%
TSB	8.74%
Virgin/Yorkshire Bank	9.49%
Non-bank/Specialist active lenders	
KMC/ Kensington	9.05%
Bluestone	9.25%
Precise	9.25%
Aldermore	9.73%
Vida/ Belmont Green	9.94%
Foundation Home Loans	10.24%
Pepper Money	10.45%
Together	11.3%
Larger closed book/inactive lenders	
Landmark	9.39%
Helidor/Topaz	8.74%