TOOLKIT FOR MANAGING CHALLENGES AROUND INTEREST-ONLY MORTGAGES

November 2021

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EXECUTIVE SUMMARY

This document was created to be a resource for mortgage lenders managing a back book of maturing interest-only mortgages. It was originally produced in 2010 by the Council of Mortgage Lenders, a predecessor organisation to UK Finance. It has undergone iterative updates in 2013, 2018 and 2021 to reflect changes in the market and regulatory environment.

This toolkit is not meant to be prescriptive. Its purpose is to share best practice from the lender community, so that lenders may refine their communication and operational policies to meet the needs of their interest-only borrowers.

UK Finance will review the content of this document periodically. Any necessary amendments will be made with the input and approval of the UK Finance Interest-Only Mortgages Working Group.

The complete toolkit is only available to members of UK Finance's mortgage stream. Members are asked not to share this document externally.

INTRODUCTION

UK Finance data indicate that at the end of 2020 there were just 908,000 pure interest-only (IO) mortgages outstanding in the UK, and a further 277,000 on part interest-only, part repayment terms. In total, this is 12 per cent fewer than the number in 2019, and nearly two-thirds lower than in 2012 when this data was first collected.

While this is overall a positive development, it masks two trends observed by lenders:

- The cohort of long-term IO borrowers is getting smaller, such customers are also becoming increasingly difficult to make meaningful contact with.
- More recent IO mortgages have been aimed at borrowers who have a higher income and are able to make overpayments.

These two groups of customers may require different contact strategies, for example, the second group may need to be reminded of the need to make overpayments to reduce the final payment amount.

The most critical borrowers to contact are those with higher LTVs and/or closer to maturity. FCA research has revealed that customers whose mortgages will mature from 2027 onwards tend to have higher income multiples and less equity in their homes than the general cohort of IO borrowers. Additionally, IO borrowers have become an increasingly older customer population, which may have implications for future repayment options available to them.

Over the last several years, lenders have developed internal strategies to most effectively serve the needs of their IO borrowers, through targeted communication campaigns, enhanced customer service processes, and new loan products (i.e., retirement interest-only mortgages).

In 2018, UK Finance held a series of workshops for lenders to identify and build on lessons learned and best practices in mitigating the repayment and conduct risks associated with IO mortgages. This toolkit[1] drew on the discussions held at these workshops. A similar process was used to make refinements to the document presented here.

We hope members find this toolkit useful in developing policies for managing the maturity wave of their IO mortgage back book.

The toolkit is not meant to be prescriptive. Instead, it sets out insight and lessons learned shared from the lender community. It is published with the intention of sharing best practice so that lenders may refine their communication strategies to meet the needs of their borrowers. The information only applies to residential owner-occupied mortgages, where the property is the borrower's home. Buy-to-let, second homes and equity release mortgages are not covered by this toolkit.

We have reviewed the content of the toolkit to reflect the FCA's 2018 thematic work on the fair treatment of IO mortgage borrowers, as well as the 2013 Finalised Guidance on Dealing fairly with IO mortgage customers.[2]

The Covid-19 pandemic caused considerable financial distress to a number of customers. Lenders and the FCA worked together to ensure that customers were treated fairly through the use of temporary payment deferrals including guidance stating that firms should allow borrowers to delay repayment of the capital at maturity on interest-only and part-and-part mortgages up to 31 October 2021, provided borrowers are up-to-date with payments and they continue to make interest payments. These temporary measures have now come to an end but lenders should be aware of their existence when reviewing customer files.

The toolkit is intended to be a working document and will be updated periodically to reflect regulatory and market developments.

1 The original IO toolkit was produced in 2010 and updated in 2013 by the Council of Mortgage Lenders (CML), a predecessor organisation to UK Finance.

2 TR18/1 available here; Finalised Guidance here.

PART 1: AN OVERVIEW OF CUSTOMER RESEARCH AND DATA

This section will discuss how lenders can use data to segment their customer base, which can then be used to inform and refine their communication strategies for various customer types.

Firms should note that some information provided goes beyond the expectations set out in FG13/07. In this guidance, the FCA advises firms to increase the frequency of their communications as the customer approaches the end of the mortgage term, but there is no expectation that segmentation be applied to communications.

1.1. One of the key themes from the FCA's 2018 thematic review on IO borrowers is that customer and loan performance data is considered an important tool for helping lenders understand how best to engage with their customers. Using data can both inform a lender's contact strategy and help lenders identify which customers may be more at risk for repayment issues.

1.2. From the IO workshop sessions held by UK Finance, it was evident that all lenders had either undertaken or were considering some form of a segmentation and analysis exercise. However, firms varied in the level of detail at which they found it appropriate to apply the segmentation.

1.3. Several early adopters of segmentation had undertaken market research or test campaigns to optimise their communication strategies. These firms found that analysing the aggregate response rate of a campaign could mask differences among various customer segments, which might lead them to pursue a communication strategy that is effective for one group, but ineffective for another.

1.4. The key dimensions listed below were some of the most common ways in which a back book can be segmented:

- Time to loan maturity (or time past maturity, if applicable)
- Household income of borrower(s)
- Size of balance outstanding
- Value of mortgaged property or equity position
- Geographic location of the mortgaged borrowers
- Repayment plan characteristics/vehicle
- Customer's age at maturity

1.5. Each firm will need to come to its own position on the degree to which they should analyse and segment their book. The level of sophistication that a firm will require to segment their customers segments will depend on the profile of their back book, and how much variation exists in key loan characteristics.

1.6. A firm which has a relatively homogenous back book may feel justified in taking a very simple approach to segmentation—for example, just looking at time to maturity and tailoring engagement with customers on that basis. However, firms should consider using additional information to inform the approach, presuming the data is available and reliable.

1.7. On the other hand, a firm whose back book contains many different borrower types and loan types (particularly if the loan maturities span a long period of time) may prefer a more complex approach to segmentation which looks at several dimensions. A firm such as this may be able to identify 100 or more various segments within their customer base. While it may not be feasible to tailor communications to all types of customers, a good understanding of customer types can be useful in optimising the communication strategy.

Using data to assess risk of payment shortfall

1.8. By considering case studies and trends within their own firms, lenders have identified that certain loan or customer characteristics can be a signal for future repayment issues. The table below sets out various characteristics that a lender might observe or capture, and what type of risk it may signal to the lender.

1.9. To a large degree, this information is based on anecdote and observation, so lenders using this information should consider these correlations to be “rules of thumb” rather than statistically-robust evidence.

1.10. When using data to segment and analyse the profile of their customers, lenders should always adhere to best practice and legal requirements around the use and storage of personal data.

Known Aspect of Borrower/ Loan	What can be inferred
Geographic location of the mortgaged borrowers	As with property value or equity considerations, understanding the local housing market of the borrower may provide insight as to whether sale of property is an option that the borrower will consider and is a viable repayment option.
Age at maturity	This will impact the options and products which customers may be able to access at loan maturity.
Vulnerability status	This topic is discussed in greater detail in Part 6 of the toolkit. Firms will have their own definitions and policies around dealing with customers in vulnerable circumstances. From the perspective of grouping and segmenting the customer book, it is considered good practice to consider the circumstances of these individuals more broadly than those of a standard customer.
Time to loan maturity (or time past maturity, if applicable)	Most lenders already segment their book based on time to maturity (or time past maturity, as the case may be). Lenders will often adjust the tone of the letters sent to customers approaching maturity to emphasize the importance of getting in touch and the consequences if the customer does not.
Income and Payment characteristics	From periodic conversations with borrowers, lenders may be able to collect information about whether a borrower is unemployed, has a low income, or relies on Support for Mortgage Interest (SMI). Lenders may choose to tailor the tone and information provided to these customers to present options which are appropriate for the circumstances. Some lenders have observed that borrowers whose income was self-certified at loan application are more likely need help in getting their repayment plan on track.
Value of mortgaged property or equity position	For a loan that is performing, lenders normally would not have any cause to monitor or verify the property’s value. Nevertheless, it may be useful in understanding the customer’s equity position, which would affect whether sale of property may be a possible repayment vehicle (RV) for the customer. Particularly when no RV is recorded, lenders may find it useful to consider the customer’s equity position when reaching out with generic information (which does not steer the customer toward any particular solution) around repayment options. Lenders may use local house price data to model their customers’ current expected property values. Likewise, they may extrapolate the property value using house price indices (HPI) or automated valuation models (AVM). While lenders may consider different metrics (ie, LTV, DTV, or estimated value of equity), it is used to help understand the repayment options available to the customer and whether a sale of the property is a viable repayment option. In some instances, lenders have found from experience that mentioning the idea of property sale can cause the customer to disengage from discussions entirely, if the customer is not prepared for it.

Known Aspect of Borrower/ Loan	What can be inferred
Size of balance outstanding	Borrowers with a low balance outstanding often have an easier time repaying their loan and may be a lower risk. Lenders often choose to put these borrowers onto a lower priority communication strategy so that more resource can be used for higher-risk borrowers. It is sometimes thought that a borrower with a large capital payment due could be deterred from responding to the lender's communication because they are overwhelmed by the prospect of making a large repayment. Lender experience has shown that this is not always true. Some customers with a large balance outstanding may be highly sophisticated customers who understand the benefits and risks of being highly leveraged. These consumers may not see any personal benefit in responding to what they perceive to be generic communications. If a firm can identify this type of customer, it may be able to increase the likelihood of response by pitching letters and leaflets at a more advanced level.
	Repayment vehicles (RVs) may not always be known by the lender. This is a risk factor, as it may suggest that the borrower has no plan. Even when RVs are recorded, some are known to be riskier (for example, ISAs). Knowing the customer has a risky or no RV typically drives the lender to a more targeted engagement strategy. Some repayment characteristics may suggest that the borrower is at lower risk of non-repayment or payment shortfall—for example, having a history of regular overpayments. Similarly lenders are mindful of the risk that customers may change the intended RV. For example in some instances the RV may be known to the lender, as at the outset of the mortgage the customer may not have given much consideration to the repayment vehicle they intended to use and for ease simply selected the option of 'sale of property'. However as term expiry draws near, the borrower may change their mind (or their circumstances may change) and they no longer wish to use the intended RV. Lenders may consider including details of the RV the customer has stated they intend to use within their communication strategy to remind the customer to help mitigate this risk factor.

CASE STUDY 1: USING RISK SEGMENTATION TO OPTIMISE MAILING FREQUENCY

Firm A has shared how they used a segmented contact strategy to inform the frequency of their schedule for regular reminder mailings.

The lender categorises their book into high, medium and low risk segments. The segmentation is partly informed by an internal credit risk scorecard which was built to predict interest-only outcomes at term-end. Further logic is then applied when allocating residential IO accounts into high, medium or low risk segments:

Low Risk	**More than 10 years from maturity and the following characteristics:** • Balance is low • Risk score from the internal scorecard suggests low risk
High Risk	**Less than 10 years from maturity and the following characteristics:** • Risk score from the internal scorecard suggests high risk
Medium Risk	**All other customers**

Following an initial letter, the lender attempts to hold a meaningful conversation with the customer to determine whether they have a repayment vehicle, and if so, whether the customer is on track to redeem the mortgage at maturity.

Using risk-segmentation and the information held about the customer's RV, reminder mailings are sent out according to this schedule:

	RV is known and currently acceptable	RV known but not currently acceptable	RV not known
High Risk	Every 3 Years	Annually	Annually
Medium Risk; within 10 years to maturity	Every 3 Years	Every 2 years	Annually
Medium Risk; 10yrs + to maturity	Every 3 Years	Every 2 years	Every 2 years
Low risk	Every 5 years	Every 3 Years	Every 3 Years
Customer in Arrears	Contact in accordance with Arrears policy		

Certain customer types are excluded from this exercise and dealt with according to different contact strategies. These include customers within 18 months of maturity (who are put onto a "countdown" communication plan), customers past maturity, customers in arrears, and deceased customers.

Firms should note that this case study goes beyond the expectations set out in FG13/07. In this guidance, the FCA advises firms to increase the frequency of their communications as the customer approaches the end of the mortgage term, but there is no expectation that segmentation be applied to communications.

PART 2: COMMUNICATING WITH BORROWERS

This section will discuss the pros and cons of the most common tools for reaching out to borrowers or encouraging contact from the customer, including:

- Annual mortgage statements
- A letter to the borrower
- Leaflets or booklets with general information
- Outbound phone calls
- Enclosure of forms for customers to report or confirm their repayment vehicle
- Online forms for customers to get in touch

Real-life case studies shared by UK Finance members are provided at the end of this section.

2.1. There are many possible ways of engaging with the borrower to remind them of their repayment obligation or to prompt them to respond with more information. Experience from lenders has shown that there is no one single communication strategy that is always effective. Instead, lenders tend to get best results when adjusting the frequency and tone of communication so that it is appropriate to the individual customer's circumstances.

2.2. Clearly, a fully individualised outreach strategy is not feasible or proportionate for most lenders. However, applying a segmented communication strategy may be a satisfactory compromise between a generic communication strategy and personal account management.

Reaching out: the basic tools

2.3. Lenders reported that generally there appears to be a high likelihood that a borrower will read their annual mortgage statement. MCOB 7.5.3R provides information on what must be included in a mortgage statement.

2.4. Letters to customers are another common tool in communication strategies. There are several benefits to incorporating letters into the backbone of a communication strategy. Firstly, letters provide a useful audit trail for the lender to evidence that contact was attempted. Secondly, they legitimise a follow-up call to the borrower. Experience from lenders suggests that customers find unprompted calls regarding their mortgage suspicious. While the letter itself typically does not drive engagement, it tends to make the follow-up call more effective. The customers are found to be more responsive in phone calls where the call was preceded by a letter. Thirdly, letters can be used to "playback" information that the customer provided in a phone call, which again provides an audit trail for lenders.

2.5. Typically, letters include information specific to the borrower, such as the balance and the maturity date of the loan. It is key for letters to emphasize the reason for writing and any next steps required from the borrower. Consumer research from the FCA found that customers would often take no action after receiving a letter if it appeared to lack clarity and purpose.

2.6. Lenders may often enclose a leaflet/booklet with the mortgage statement or letter to prompt customers to make contact. Although leaflets can provide greater depth of information than would be included in a letter, experience has shown that leaflets that are either too information-heavy or too generic can deter customers from responding. Lenders who have tested targeted leaflets report higher levels of engagement than would otherwise result from

sending a generic leaflet. Case Study 4 at the end of this section shows a targeted leaflet used by one lender.

2.7. Lenders who have used leaflets as part of a communication campaign which includes follow-up outbound phone calls have found that sending the customer a leaflet/booklet in advance has helped prepare the customer for the subsequent phone call, even if the leaflet gives generic information. The FCA have produced a customer leaflet that lenders may wish to send to customers, it can be found at https://www.fca.org.uk/publication/documents/interest-only-mortgages-act-now.pdf.

2.8. Phone calls are another commonly used tool for reaching out to borrowers. Experience has shown that the effectiveness of a phone call depends on how prepared the customer is when the call is received. Unprompted calls can have mixed results. However, consumers who have previously responded to lender communication and have been forthcoming with information about their RV are more likely to engage favourably with an unprompted call.

2.9. For IO mortgages lent after April 2014, MCOB 11.6.49R requires contact be made at least once during the term of the mortgage to check that repayment strategy is still sustainable. However, the FCA encourages the now widely adopted practice of contacting all interest-only customers at pre-specified intervals during the mortgage term and increasing the frequency of contact as customers move closer to maturity. When writing to customers, firms should also ensure that the tone of communication is proportionate to the customer's circumstances. Letters and leaflets sent closer to maturity should adopt a more direct tone than those sent earlier in the mortgage term.

2.10. As per the FCA's Finalised Guidance (FG13/07), lender communications should also set out the options available if a customer is concerned that they may be unable to repay their loan at the end of the mortgage term and detail, in a balanced way, any potential risks of not taking action in this situation.

2.11. Case study 2 provides an example of one large lender's pre-maturity contact strategy.

Collecting information from customers

2.12. While one key goal of communicating is to remind customers of their obligation to pay, another is to encourage customers to get in touch and provide up-to-date information about their circumstances and RV.

2.13. The most commonly used methods of collecting information are either phoning the customer, encouraging the customer to phone, or enclosing a form with a letter which allows the customer to indicate new information about their intention and circumstances. The form may request evidence about the intended repayment vehicle or require a customer declaration to confirm that the repayment plan is on track.

2.14. An example of one lender's form for collecting information on the intended repayment vehicle is included in case study 5.

2.15. In tailoring their IO communication strategies, firms should bear in mind that a customer's circumstances may have changed due to a life event. This may affect the customer's repayment plans or even whether the customer responds to contact from the lender. Firms may wish to ensure that any communication material they provide encourages customers to contact the customer service team to explore options if a major life event has impacted their plans.

2.16. Recently, lenders have started using websites to allow customers to update their RV information online. While this has not been widely tested so far, it may prove to be a convenient and low-cost alternative to phone calls and forms. One finding from an IO campaign conducted by a large closed-book lender revealed that 45 per cent of customers would have chosen to get in touch online if that were an available option.

2.17. Many lenders choose to outsource their interest-only contact strategy to third party administrators (TPAs) either in whole or in part. Any outsourcing arrangement should comply with the requirements of SYSC 8 in the FCA's Handbook.

2.18. It is important to ensure that there is a clear understanding between the lender and the TPA as

to what is required in terms of pre-expiry and post-expiry contact with the customer (both in terms of frequency of contact and how it would be expected that would be done), when the lender would expect litigation action to be taken (or not), how vulnerable customers should be dealt with and what decisions should be referred to the lender. This can be done through the lender providing their process for the TPA to work to or through the TPA having a standard process that the lender is comfortable with. It is important that clear mandates are set with the TPA. It is also important that sufficient oversight and governance arrangements are put in place to ensure that customers are being treated as the lender would expect and to meet the requirements of SYSC 8.

Being aware of customer awareness

2.19. One lesson lenders have learned from experience and market research is that customer may have very different levels of awareness, both around the particulars of their own loan and of IO loans in general. The following is a list of issues which borrowers may commonly misunderstand or simply forget. When developing new templates for letters, leaflets, or phone scripts, lenders may wish to use this as a checklist to ensure the material they are producing is not overly presumptuous of a customer's understanding.

- The concept that IO mortgages are fundamentally different to capital repayment mortgages
- That the borrower has an obligation to pay a lump sum at the end of mortgage term and that there are consequences for failing to do so
- The amount of the lump sum that the customer will have to repay at the end of the mortgage term and when that is due
- The option to make overpayments, and that in many cases overpayments have no consequences (such as early repayment charges) but will reduce the amount the customer will owe at the end of the mortgage
- If the customer was previously on a capital repayment loan and switched to IO as a temporary measure, they may not recognise that they are no longer paying down the capital, or that switching back to capital repayment will likely increase the monthly repayments
- Advice: customers are unlikely to realise that a mortgage advisor can advise on the mortgage, but, as per MCOB 4.7A.10G, firms are not required to advise the customer on a credible repayment strategy or assess the adequacy of a customer's existing repayment strategy.
- Customers are also unlikely to realise that not all mortgage advisors are able to advise on all mortgage products which extend into retirement, and that only an independent financial advisor (IFA) will be able to provide advice across all financial products
- Breach of contract: customers may not understand that missing the contractual lump-sum payment at the end of the mortgage term is considered legally a breach of contract, whereas simply missing an interest payment during the mortgage term is not.

CASE STUDY 2: A MULTI-PRONGED PRE-MATURITY CONTACT STRATEGY

Lender Q has a large IO book with maturities peaking in 2032. From the year 2026, the number of maturities will start to steadily increase. The RV for just over 50 per cent of customers is held on record. Almost 90 per cent of customers report that their repayment plan is on track.

Pre-maturity IO customers are contacted in regular mailings to encourage them to put in place suitable plans and address any shortfalls. All mailings include a **repayment vehicle form** that customers can post back in a pre-paid envelope, and a **colour leaflet with options** on repaying their IO mortgage.

All customers can also call to update their plan. Of the customers who have responded to date, about 60 per cent return the form, while 40 per cent call the lender. Those stating a shortfall in their plan receive **a follow-up letter which sets out options and recommends a call with a mortgage adviser.**

Customers on a 25-year term receive eight or nine mailings throughout their term. The frequency of mailings increases as the loan nears maturity. The lender issues letters at 7,5,3,2, and 1 year pre-maturity. All customers also continue to receive IO specific messages in the **annual mortgage statement mailing**.

CASE STUDY 3: EXPERIENCES OF INNOVATIVE COMMUNICATION CHANNELS

Some lenders have reported testing less conventional methods of contacting borrowers. The table below lists methods of communication which some firms have trialled, and the effectiveness of each. Naturally, firms may have differing experiences with trialling new communication tools. Firms should only consider adopting communication methods which are appropriate given their business model and customer base.

Communication tool	Lenders' experience
Dedicated IO website	This can be a platform for providing illustrative tools that customers can use to model affordability under a switch to capital repayment or an interest rate rise. Customers can be directed to the website through the URL provided in a letter. The lender can track the effectiveness of different campaigns through a URL that is tailored to the campaign. Customers who do not want to enter personal information online can have the option of using a printable PDF to declare their repayment vehicle
Mailings in branded envelopes	Borrowers may respond more favourably to a mailing that appears to carry more weight.
Video conferencing	Some borrowers will be comfortable with a video chat, particularly if they used the function in another capacity before.
Email reminders	Customers have been conditioned to view emails from financial institutions as suspicious
Christmas cards and flyers intended to evoke an emotional response	Customers typically ignore these or respond negatively
Text message reminders	This has not been widely tested. It is thought that text message communication may be adopted by mortgage lenders if it is proven to be an effective tool in the retail banking space. However, lenders are unlikely to have mobile numbers for long-standing mortgage borrowers.
Social media posts to raise awareness	This has not widely tested but may be pursued in mortgages if other aspects of retail banking find ways of driving engagement through it.

CASE STUDY 4: A LEAFLET SHOWING EXAMPLES OF OPTIONS CUSTOMERS HAVE TAKEN

Borrowers have been known to ignore leaflets which either appear overly generic or contain too much information.

The following is an example of information in a targeted leaflet which may be sent to customers who have been identified as not having any RV, and not willing or able to sell their property. The leaflet focusses on case studies and does not overload the customer with too much information.

Case Study 1

We helped Mr and Mrs X take control of their mortgage and plan to own their home at the end of the term

With no plans in place to repay their interest-only mortgage, Mr and Mrs X contacted one of our interest-only specialists to discuss their circumstances and find a solution.

Mrs X said that although they regularly pay their interest-only mortgage payments each month, they were worried about what would happen when their mortgage came to an end. They have no way of repaying their total remaining mortgage amount, and they feel that their income is too low to increase their monthly repayments.

After two one-hour discussions over the phone about their circumstances and current budget, we recommended a solution that was right for them:

- to change from interest-only to a repayment mortgage - so every mortgage payment they make will reduce the amount they owe
- to transfer them to a two year Flexible Fixed rate mortgage - this will put them on a lower interest rate and give them stability in their payments
- to increase the term of their mortgage so it's more affordable.

This solution, which was tailored to Mr and Mrs X's needs, meant that the monthly payments are a figure they're comfortable with, and they now feel in control of their mortgage for the first time since 2005. (As long as all payments are made in full and on time during the remaining term.)

A quick overview

Before:

- they'd need approximately £30,000 almost immediately to repay their mortgage at the end of the term
- one way to fund this would be to look for alternative borrowing, such as an unsecured loan
- an alternative would have been to sell the family home to repay the mortgage.

After:

- by discussing their current needs and circumstances we were able to agree a monthly mortgage payment that Mr and Mrs X were comfortable with. We've ensured they have enough money to live off after paying their mortgage each month
- as long as they follow their new mortgage plan they'll own their home outright at the end of the new term.

Case Study 2

We helped Mrs Y transfer her mortgage to a repayment mortgage and reduce her interest rate

Retired and with no plans in place to repay her interest-only mortgage, Mrs Y was worried about contacting us in case it meant selling her home. After talking to our interest-only specialists she explained that she had originally intended to sell her Buy to Let property to repay her interest-only mortgage, but her plans have had to change.

After talking to us about her current situation, we recommended a solution that was right for her:

- to change from an interest-only to a repayment mortgage so that every mortgage payment she makes reduces the amount she owes
- to extend her mortgage term so her repayments are manageable
- to transfer her to a five year Flexible Fixed rate that reduces her interest rate.

This individually tailored solution means that the monthly payments are a figure Mrs Y is comfortable with, and she feels in control of her mortgage again. (This assumes all payments are made in full and on time during the remaining term.)

A quick overview

Before:

- Mrs Y would need to sell her Buy to Let property within a year to release the money to pay off her interest-only mortgage on her home
- her retirement income would be reduced by the lack of rental income following the sale of the property.

After:

- as long as she pays her new mortgage plan, she'll own her home outright at the end of the term
- her retirement income won't be reduced as she'll still be receiving rental income from her Buy to Let property
- by discussing her situation, we were able to agree a new mortgage and ensure Mrs Y could budget efficiently.

We're here to support you

As a responsible lender we're committed to supporting you. However, before we can help you, we need to understand your plans. Please call us on 0800 as soon as possible. Our dedicated interest-only Services Team are waiting to work with you and are available Monday to Friday 8am to 8pm and Saturday 9am to 2pm.

Let's put plans in place together today.

CASE STUDY 5: A FORM WHICH ALLOWS THE CUSTOMER TO PROVIDE INFORMATION ON THEIR RV

Account Number	
Customer Name	

Interest Only Mortgage Repayment Strategy details

Please indicate on the form below the details of your plan to pay off your original loan by the end of your mortgage term. Please fill in as much detail as you can then return to us in the envelope provided. Select which out of the 10 options below apply to you & fill in that section of the form.

1 Endowment Tick

2 Pension plan lump sum Tick

3 Investments Property ☐ Stocks & Shares ☐ Other ☐ Tick

When will you have access to funds? MM YY

Expected amount £

Is your plan on track? Yes ☐ No ☐

4 Savings Tick

Current balance £

Monthly savings £

5 Selling your home Tick

Estimated sale date MM YY

Estimated current property value £

6 Remortgaging elsewhere Tick

Estimated remortgage date MM YY

Estimated current property value £

7 Switching to repayment Tick

When do you plan to switch? MM YY

How much of your mortgage do you plan to switch to repayment? All ☐ Part ☐ £ if Part £

8 Monthly overpayments Tick

- I currently overpay by £
- I plan to overpay by £

When do you plan to start? MM YY

9 Other plan Tick

What is your plan?

When will you have access to funds? MM YY

Expected amount £

Is your plan on track? Yes ☐ No ☐

10 I have no plan in place to repay my mortgage at the end of the term Tick

Contact details To ensure that our records are up to date, please confirm your phone number.

Telephone No.

Interest Only Review Programme

We have introduced the Interest Only Review Programme, which offers support to help you set up a repayment strategy (or help develop your existing plans) and includes reviews with us at key mortgage milestones in the future.

Finally, we would like to thank you for taking the time to complete this form. Please sign below to confirm that the details captured above accurately reflect the plans you currently have in place to repay your loan by the end of the term. Whilst we have asked for this information to update our records, it is your responsibility to regularly review your plan to ensure it is on track to repay the mortgage balance in full when due.

Signature(s)　Date

CASE STUDY 6: OUTSOURCING THE TASK OF CONTACTING CUSTOMERS TO A SPECIALIST

In August 2015, one lender held information of RV plans for only 20 per cent of their IO customers. Up to that point, their strategy had been to send regular mailings to their IO customers, requesting that the customer phone to discuss their repayment strategy. The mailings had proved to be costly with relatively low response rates. Despite multiple mailings, some borrowers were simply not engaging.

As a result, the lender sought the help of a third party which specialised in contacting hard to reach customers. "Company D" began tracking and contacting customers on behalf of the lender. Initially, Company D would simply contact the customer over the phone and then do a live hand-off so the lender could collect the customer's RV or have a discussion if no strategy was in place. This process was then enhanced so that Company D became able to collect the repayment strategy directly from the customer.

As of April 2018, the lender held information of RV plans for 65 per cent of their IO customers. Since using the third party they have also reported a greater number of customers willing to explore options, such as switching their mortgage to repayment or making other variations to ensure they remain on track.

The lender also reported success in using this third party to contact specific segments of their book, including vulnerable customers, customers in high-risk geographic areas, or customers approaching term end. Company D was also able to collect additional information from customers which helped shape the lender's communication strategy, including:

- Up to date customer details for phone number and address
- Details of residential customers who are now letting their property
- Information that could mean potential impairment

PART 3: OPTIONS FOR LENDERS AND BORROWERS

This section provides information on how lenders can guide their borrowers towards appropriate repayment solutions. Specifically, it will discuss:

- Options which may be undertaken without advice or an affordability assessment.
- Options which may entail an affordability assessment or require advice.
- An example of a typical customer journey when exploring options.
- How lenders may proceed if no viable repayment strategy is found after all other options have been exhausted

Only customer-facing issues relating to repayment options will be discussed in this section. Non-customer facing issues (for example, impairment events, securitisation) are discussed in Part 5.

Real-life case studies from lenders are provided at the end of section 3.

The advice permissions held by the mortgage lender will to a large extent determine how customer the customer can be guided along their journey. Lenders are required to hold the relevant advice permission in order to make any personal recommendation which steers the customer, either explicitly or implicitly, to a particular regulated mortgage contract, as per PERG 4.6.5G. However, presenting the borrower with information about the choices available to them without making a recommendation or steering them to a particular regulated mortgage contract does not constitute regulated advice, and can be done on an execution-only (EO) basis. Lenders will not always hold advising permissions or may choose not to provide advice to customers about their mortgage options. Alternatively, customers may choose to seek independent financial advice though a broker or intermediary, or where applicable transact on an execution only basis.

Lenders should also bear in mind their obligation to act in accordance with MCOB 2.5A which requires firms to honestly, fairly and professionally in accordance with the best interests of its customer.

1. Options which may not require an affordability assessment or advice

Generally, the following options may be discussed with the customer and do not require regulated advice, provided they are not personal recommendations and do not steer a customer toward a particular product:

- Making larger monthly payment
- Making regular overpayments
- Make one-off or occasional lump sum payments
- Changing the customer's interest rate via a product switch with no additional borrowing
- Selling the property and downsizing to pay the loan

Typically, making additional voluntary payments is the most flexible option for the customer, as it does not contractually obligate them to larger payments. However, it does not guarantee the lender that the loan will be paid off at maturity. Overpayments can also be eroded if there is a rate rise and the customer is on a reversion rate, unless the customer increases the overpayment in line with the variable rate they are on. Depending on the features of their particular product, customers may incur fees for overpayments. Lenders may wish to consider waiving these fees to encourage customers to overpay.

Discussing the option of sale of property should be a delicately handled matter. The use of Assisted Voluntary Sales (AVS) can be appropriate in some circumstances, however if they can also pose reputation risks for lenders if they are not handled carefully. Lender may wish to refer to the CML's guidance, Assisted voluntary sales and exiting homeownership, as well as research by the University of York, to inform their approach around talking to their borrowers about the benefits of selling their home.

2. Options which require an affordability assessment and may require advice

The variation of an unregulated residential mortgage contract that was entered into before 31 October 2004 does not require regulated advice. However, if the contract variation results in the creation of a new regulated mortgage contract, then the customer will normally take advice. Customers can elect to proceed with a new contract on an execution only basis if the lender does not have advice permissions. However, the lender can only go down this route under the instruction of the borrower and must follow the requirements for execution only sales set out in MCOB 4.8A.

Irrespective of advice, the options listed below would require the lender to undertake an affordability assessment to ensure that the borrower can afford the new payments.

- Extending the mortgage term
- Conversion of all or part of the loan to a repayment basis
- Switching to a retirement IO mortgage
- Switching to a lifetime mortgage

Lenders should note that the amended affordability assessment can be applied if the new arrangements are "like for like" i.e., the customers does not want to borrow more, other than to finance any relevant product, arrangement or intermediary fee for that mortgage and is looking to switch to a new mortgage deal on their current property

Extending the term of the mortgage, and/or moving the borrower to a capital repayment mortgage (full or part-and-part)

When extending the term, the lender needs to consider whether any specific warnings regarding the impacts of the action are necessary (i.e. that the extension of term will increase the amount of interest payable over the life of the mortgage); and if the new term will take the borrower into retirement.

Additionally, there are non-consumer-facing issues around extending the term (ie, the potential for an impairment event, and where options may potentially be reduced where a loan is securitized). These are discussed in Section 5 of the toolkit.

Lenders often prefer to move the borrower to capital repayment terms at the same time as extending the term. The feasibility of this will depend on the circumstances of the borrower, the length of the term extension and, ultimately, if it is affordable.

Lenders will design their own individual affordability models to strike the right balance between the appetite for new business lending and the amount of risk already in place on their back book. With an existing interest-only back book, the lender may choose to apply an affordability assessment that differs to their usual practice but still ensures a good customer outcome is delivered. Such cases should be trialled on an individual basis, and periodically reviewed to ensure borrowers are getting a fair outcome. Lenders should also document the cases in which they deviate from their standard lending policy and should record their reasons for doing so, so that this can be justified to regulators if need be.

Case study 7 gives a successful real-life example of extending the term and moving the customer to capital and interest repayments.

If the customer cannot pass an affordability assessment for the full amount of the mortgage, the lender may offer to move the customer to part & part repayment terms, so that the customer is making progress towards paying down the loan in manageable instalments. Under these circumstances, lenders may also require that the borrower provide a "Sale of Property" declaration, as, unless overpayments are made, the customer would still owe a portion of the loan at the end of term.

An example of a lender's Sale of Property declaration is provided at the end of this section of the toolkit.

Lenders who do not have active lending permissions should ensure their process and options are appropriate to the customer and result in a good customer outcome.

Applying for a retirement interest-only product

A retirement interest-only mortgage (RIO) may be an option available to eligible borrowers who can demonstrate affordability but need extra time to repay their mortgage balance, or who can afford to remain in their home until their death or a move into long-term care. There is no obligation on a lender to provide a RIO product. Where a RIO option is available, Lenders should take care to ensure their communication sets out clear positions around repayment obligations when the property is sold or the borrower(s) pass away.

RIO mortgages are not necessarily an alternative to lifetime mortgages. It may be appropriate for some customers to first take out a RIO, and once their age and LTV positions are suitable, transfer onto a lifetime mortgage. Lenders who do not have active lending permissions or do not offer RIO mortgages should have systems in place to allow borrowers to consider this solution, if it is appropriate for the individual.

The adviser will need to undertake an affordability assessment if a customer wants to apply for a RIO mortgage.

Applying for a lifetime product

For borrowers who meet the necessary age and LTV requirements, a lifetime product may be an appropriate solution to allow them to remain in their home.

However, there are clear challenges in helping borrowers access these products. Lifetime mortgage lending and advice is characterised by a different regulatory environment, different lending institutions, and different distribution systems, relative to the market for standard residential mortgages. Consumers are unlikely to be aware of the complexity of the market and are therefore unlikely to navigate this market unaided.

While it is technically possible for a lifetime product to be sold on an execution-only basis, this approach is not condoned by the industry. The Equity Release Council's Rules and Guidance on the matter state, "Provider members are not permitted to accept execution-only business. Sales must always be made on an advised basis, with a personal recommendation being given to the customer."

Lenders who operate in the residential mortgage market who do not offer lifetime mortgages (directly or by referral) should review their options available to ensure customers can still receive a good customer outcome. This typically happens through signposting the customer to obtain independent financial advice or a referral to a specialist lifetime mortgage intermediary.

Case study 8 gives an example of appropriately directing a borrower to a lifetime mortgage provider.

3. A typical customer journey involving a new regulated mortgage contract

The following gives an example of a typical journey where a new loan is agreed. For customers choosing an execution only route, the journey will not involve fact-finding or advice. Not all lenders provide in-house advice—in these cases the journey may involve a broker.

- Initial conversations with the relevant customer services team
- Fact finding (if customer is taking advice)
- Advice appointment (if customer is taking advice)
- Time for customer to think before decision making

1. Initial conversations

At this stage, lenders should initially confirm with the customer that they understand they have an interest-only loan, and what the implications are for repayment. Best practice is to playback to the customer information about their balance outstanding and their most recently reported repayment vehicle, if such information is held.

Lenders have observed that customers may find it difficult to discuss the concrete figures of their balance outstanding. This may prompt the customer to disengage from the conversation.

In these cases, it may reassure the customer if they can work backwards around the customer's disposable income and build a repayment solution around this.

Confirming the intended repayment vehicle (RV) of a borrower can be a challenging aspect of the conversation. In some cases, the RV may have been recorded at application but not completion. Lender may choose to seek re-confirmation of the current RV rather than use the RV recorded at application. In some cases, the original intended RV is no longer available to the customer.

In many cases, customers may not have any contractual obligation to provide evidence of repayment vehicle. The consensus view from lenders is that, under these cases, requiring evidence of an RV can only be justified if the borrower is asking for additional funds or if the contract is varied in some way.

When a customer is in arrears, addressing the arrears problem is normally a higher priority than capturing or playing-back the repayment strategy.

2. Fact Finding (if advised)

If the customer is going down the route of an advised sale, the lender or brokers will next proceed with their standard processes for collect all the necessary information about the client's knowledge and experience, financial situation and repayment objectives, to make suitable personal recommendations.

While the length of the fact find process may act as a potential barrier to the consumer seeking advice and/or switching to a new adviser, it is an essential part of ensuring that the customer is offered a suitable product. Lenders should ensure that the requirements of MCOB 7.4A are fully met when sales are advised.

3. Advice appointment

At this stage, the customer would go through the formal advice process with a qualified CEMAP 3 (or equivalent) advisor.

4. Time to Think

Under MCOB 6A.3.4, customers offered a new mortgage contract are entitled to a minimum seven-day reflection period, during which the offer is binding on the lender. If during the timeframe, the borrower chooses to decline the loan, then the journey may come to an end, or be put on hold until the borrower is ready to proceed again.

4. When voluntary options have been exhausted

Informal temporary arrangements

After a loan has reached maturity and has not been repaid, lenders may allow an informal temporary arrangement, which may be a waiver, a grace period, or stay of action. Under these options, lenders temporarily refrain from demanding repayment or pursuing litigation.

The rationale behind this approach is that pausing legal action to give the customer time to sell (or find another way to repay the capital) ensures that all options have been fully explored and repossession is a last resort.

As a rule of thumb, firms generally limit any stay of action to 12-24 months. Under extenuating circumstances (such as a vulnerability) lenders may choose to increase the length of the grace period. If the customer's repayment vehicle (RV) is inheritance or the maturity of an investment, this might inform the length of a stay of action. Where sale of property is the RV, firms may consider the state of the local housing market when determining the length of the stay of action.

If going down this route, a lender should write to the borrower explaining what temporary measure the lender will permit. The lender should clearly set out information giving the date this agreement will end and the terms applicable to the stay of action and any conditions the lender requires. For example, the lender may expect the borrower to provide an update on the sale of their property every two months. The lender should also make clear that the customer is continuing to accrue interest according to the terms and conditions which applied pre-maturity and should clearly state whether monthly payments are required.

Assisted Voluntary Sales (AVS) have been piloted in the past, albeit with limited success. Often this is because customers want to be fully in control of the sales process and consider factors such as any loss of entitlement of council housing if their home is possessed, but not if the sale is voluntary. To avoid complications from these types of situations, firms should seek to establish early on (ideally before loan maturity) if the customer is genuinely willing to sell their property to repay the mortgage as it might be difficult to distinguish between customers who genuinely wanted to sell their property from those who were using the process to delay possession.

Firms may incentivise a customer to opt for voluntary sale or once in the scheme, be incentivised to cooperate through debt forgiveness, paying for legal and conveyancing costs, paying for estate agent costs etc.

Lenders have used Private Assisted Sale Schemes. These are where the customer deals directly with the estate agent, asset managers are not involved but monitor progress via the estate agent and verify sale price using desktop valuations/comparing with similar properties. Legal action and fees would be stayed while the customer continued to cooperate. The process takes on average nine months.

Case study 9 shows examples of good and bad practice when applying a stay of action.

When using these types of solutions, lenders should ensure their own policies are applied consistently and their policies are regularly reviewed.

Possession

Possession is always a last resort solution and would only be applicable when the borrower is in arrears or where the borrower has breached their contract by not repaying the capital at the end of the term.

Lenders have observed that, often, if a customer does not respond to pre-maturity contact, they will respond to a letter sent post-maturity which says that a field agent will be dispatched, and the lender intends to proceed with litigation. This may be an effective prompt for encouraging the customer, however, lenders should take care if they choose to dispatch field agents pre-maturity.

If the borrower is in arrears, the lender would have to adhere to the regulation in MCOB 13 and the requirements of the pre-action protocol and may litigate on the basis of arrears.

Where a borrower does not repay the capital balance at the end of the term, they are in breach of contract and the lender has the right to demand payment, including by taking possession of the property. In this case the lender would litigate on the basis of breach of contract rather than arrears. As such, the bulk of MCOB 13 will not apply. It is common practice to follow the pre-action protocol (PAP) for breach of contract litigation, even though PAP is not a legal requirement in these cases.

Securitisation

Lenders operating within securitisation programmes may have restrictions in the options that they can extend to customers. Lenders have an obligation to honour the terms of the securitisations and will ensure that their pre-maturity communications clearly outline support options available to the customer and what is expected of the customer.

CASE STUDY 7: EXTENDING THE TERM AND MOVING TO CAPITAL AND INTEREST REPAYMENT

Circumstances: A customer who was 60+ reached loan maturity and did not have funds to repay the principle. The lender's policy was not to allow mortgages past the age of 75. The borrower was still working and had high credit commitments because he had used personal financing to help keep his business afloat.

Assessment: The lender looked at the customer's income and established that the customer would be able to reasonably afford repayments of £2000 per month for two years. To build in a stress buffer, the lender agreed that the customer would only need to repay £1500 per month, with the option to make overpayments if he chose to. Through this arrangement, the customer was also able to make capital repayments, ensuring that the debt would be repaid at end of term.

The decision to sign-off this arrangement was made by an individual within the firm. It was not model based, but a bespoke decision. Clearly the potential for other firms to do this depends on the volume of cases they have.

This case study exemplifies budget-driven advice.

- Lender works backwards, first establishes what is borrower's maximum disposable income
- A lender might flex the affordability test which would normally apply to new business
- When past-term, the affordability stress rate typically becomes more lenient.

CASE STUDY 8: PRE-LITIGATION LETTER AND DIRECTING A CUSTOMER TO APPROPRIATE LIFETIME CHANNELS

A customer's mortgage had reached the final 18 months of its contract, kicking off the lender's "countdown to maturity" contact strategy. The lender issued all letters and outbound call attempts in accordance with their policy. Throughout the 18 months, the customer made no contact.

As per its policy, the lender sent a letter which explained that if no contact within the next seven days then a field agent would be instructed to visit the property.

The customer finally called. He said he had been avoiding the lender's letters and calls and was afraid that his home would be taken from him, as he had nothing to repay the mortgage.

The lender informed the customer that they had a relationship with a leading equity release broker. The customer was passed through on a 'live' transfer.

The customer was told he could obtain a "Service Lifetime" mortgage through the broker, but a shortfall was found in the amount lent and the outstanding mortgage balance. Following a further discussion with the customer, a plan was agreed for him to repay the lender £2000 per month for seven months to make up the shortfall before the lifetime product would complete.

The account was tracked monthly, and the lifetime mortgage has been completed. The customer was very happy with the outcome.

CASE STUDY 9: APPLYING A STAY OF ACTION

Positive Outcome

At loan maturity, a customer was not able to repay the balance and did not yet qualify for a lifetime mortgage. The lender and borrower came to an agreement where the customer would make overpayments temporarily past term until they were able to qualify to convert to a lifetime.

The customer met their obligation and was able to remain in their home.

Negative Outcome

A customer's interest-only term came to expiry. After a stay of action had been agreed, the customer reported a vulnerability.

The lender sent a field agent to investigate. It was confirmed that the customer had a medical situation, but it was not severe enough to be classified as a vulnerability.

At this point the customer agreed a repayment plan using their pension to chip away at the capital owed. However, shortly thereafter the customer stopped engaging. The case was still not resolved at 18 months post-maturity.

The FCA considered this a case of bad practice, as conversations which should have taken place pre-maturity were happening post-term expiry. The FCA felt that the lender ought to have taken more steps to communicate pre-maturity, and then pursue litigation within 3 months post-maturity if alternative arrangements were not made.

CASE STUDY 10: A DECLARATION OF SALE OF PROPERTY

Interest-only – SALE OF RESIDENTIAL PROPERTY (UK) CUSTOMER DECLARATION

Where any part of an FCA regulated mortgage will be on an Interest-only basis and sale of a residential property (UK) will be the repayment vehicle, each applicant must read this document and sign the declaration.

Important Information

If you take any part of your mortgage on an Interest-only basis you need to be aware of some important implications and considerations.

Implications

- An Interest-only mortgage means your mortgage balance will not reduce. Your monthly payment will only cover the interest that has to be paid on your mortgage and the amount you borrow (the capital) remains outstanding.
- At the end of your mortgage term, it is your responsibility to repay the outstanding mortgage balance.

Considerations

- As you plan to repay your mortgage by selling your property, please consider that the value of your property can go down as well as up and therefore could affect your plans – for example the type and location.
- If your property is leasehold, its value could also fall as the term remaining on your lease reduces.
- If the value of your property falls, there's a risk you may not receive enough money from its sale to repay your outstanding mortgage balance in full. Should this happen you may need to sell your mortgaged property in order to repay your mortgage balance.

Applicant 1 name

Applicant 2 name

Case reference number

Declaration

I understand the following implications and considerations of taking an Interest-only mortgage where the sale of residential property (UK) will be used to repay the capital at the end of the term:

- ☐ An Interest-only mortgage means my/our mortgage balance will not reduce. My/our monthly payment will only cover the interest that has to be paid on the mortgage and the amount I/we borrow (the capital) remains outstanding.

AND

- ☐ At the end of my/our mortgage term, I am/we are responsible for repaying the outstanding mortgage balance. If I/we do not repay the balance from our other residential property, I/we would have to sell my/our mortgaged home and use the sale proceeds to repay the mortgage.

AND

- ☐ If I/we plan to repay my/our mortgage from the sale of my/our property, I/we understand that the value of our property can go down as well as up and therefore could affect my/our plans including the type and location. For your own benefit and protection you should read these implications and considerations carefully before signing the declaration.

If you do not understand any of these implications, do not sign the form and speak to us or an independent mortgage or financial adviser.

Applicant 1 name

Applicant 2 name

Date

D D M M Y Y Y Y

YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE.

PART 4: QUALITY OF CUSTOMER INTERACTION

This section discusses ways in which firms may improve the quality of their customer interactions to reduce the risk of customer detriment due to weak links in the communication process.

In the 2018 Thematic Review on Treating Customers Fairly, the FCA identified a potential for harm where quality of customer interaction is weak. This can include:

- Lenders not following up communications, which may result in customers attaching a lack of importance to future engagement
- Lenders expecting customers to make repeated calls to chase the progress of an application, which may discourage customers from continuing to participate in the process
- Customers believing that their plans for repayment are adequate when they have provided information to front line staff but haven't had the opportunity to discuss these plans and other options in more detail

It is widely regarded that the interest-only customer journey is inherently longer and more complex than that of a typical mortgage customer, not least because IO customers tend to be older and retirement considerations often come into play. It is not uncommon for a customer to go through several different pathways along the journey. The journey of many customers can be lengthy, fragmented and complex, with periods of hiatus while the borrower either puts their research on hold or explores different sources of help and funding. This underscores the importance for ensuring that the customer is dealt with in a way which guides them towards a good customer outcome.

Although lenders may have a variety of teams which interact with teams along the customer journey, it is key to bear in mind that staff who are handling interest-only cases are appropriately trained and qualified as applicable.

For an in-depth discussion around the customer journey and challenges for signposting borrowers, see the 2017 CML research paper, Later life borrowing - New mindsets: Old silos.

Assessing the quality of customer interaction

It is good practice to periodically review a random sample of cases to assess the quality of customer interaction. Goals of such quality assurance should be for the lender to:

- Ensure no undue delay in customer interaction
- When customers reach out proactively, ensure their queries are answered promptly
- Monitor call quality
- Assure customer service teams are using mandate appropriately

In reviewing a randomly selected case, lenders may want to ask:

- What was the initial purpose of customer making contact?
- Was the customer's original issue resolved?
- How many steps/additional questions did the customer encounter.

The feedback from these quality assessments can be used to identify areas for improvement within firms' customer care procedures.

CASE STUDY 11: THE JOURNEY FOR CUSTOMERS WHO ARE CLOSE TO OR BEYOND MATURITY

The following is an example of the journey template used by one member:

- Once customers are identified, they are referred to a specialist interest-only customer service team.
- For those who cannot repay their loan in full, an income and expenditure assessment is carried out.
- The collection team screens out vulnerable customers and passes those individuals to a different team.
- Customers with a budget surplus and eligibility for mortgage contact variations are referred to a telephone mortgage advice team.
- The telephone mortgage advice team will aim to undertake a full conversion to repayment, a part and part, or in specific circumstances where customer has a near term plan to sell and downsize (e.g. moving to a retirement complex) an IO term extension may be granted. A Lifetime referral, debt charity or independent IFA referral may also be offered if appropriate.
- Customers without a budget surplus and no affordability or eligibility for mortgage contact variations are retained in collections team.
- The team will look at a range of options including using savings, investments other assets (including other properties) and sale of mortgaged property. Referrals for Lifetime, debt charity or independent IFA will be made as appropriate.
- Litigation may be considered as a last resort.

PART 5: ADDITIONAL ISSUES: CONDUCT, LEGAL, PRUDENTIAL, AND CRA REPORTING

This section discusses non-customer facing issues that lenders should be aware of:

- Conduct: What is expected around treating customers fairly
- Legal: What needs to be considered should firms pursue litigation against borrowers
- Prudential: How firms should provision for impairment and potential impairment events
- Reporting: How to report past-term issues to credit reference agencies

This section of the toolkit discusses additional aspects of loan administration specific to interest-only mortgages. This includes treating customers fairly (TCF), prudential issues, how customer data is reported to credit agencies, and the distinction between arrears events and breach of contract events.

Conduct issues: Treating customers fairly

The FCA's 2013 interest-only guidance sets out the FCA's expectations of how firms should treat their IO customers, including specific consideration for post-maturity customers who have not repaid their mortgage in full.

Among those expectations are that firms should:

- Have a formal interest-only policy which should refer to the post-maturity options which can be offered to customers in breach of contract, and the circumstances in which they will be offered;
- Have already been in contact with, or tried to be in contact with, the customer pre-maturity before the breach occurred
- Be in communication with customers post-maturity to encourage them to contact firm to agree a resolution/discuss options
- Give customers adequate time to consider the post-maturity options offered to them
- Make it clear to the customer that any variation or concession which is made to their contract after post-maturity breach of contract is done to give the customer more time to pay the outstanding capital.
- Take proactive steps to identify borrowers who could be susceptible to potential interest rate rises and treat these customers fairly.
- Provide greater flexibility to support fair treatment of individual customers, based on their specific personal and financial circumstances;
- Support and empower front-line staff to make appropriate decisions, taking care to ensure staff are treating customers consistently
- If proceeding with possession action, firms should be able to demonstrate they have tried to discuss and agree alternatives to repossession and have given customers enough time to make alternative arrangements.
- Where there is a change in the terms and conditions post-maturity, firms should document the new arrangements appropriately. By not acting quickly after the borrower's breach of contract to implement new terms, the subsequent scope for the firm to take action could be limited.

Legal issues: Distinguishing an arrears event vs. breach of contract event

An arrears event can occur either pre- or post-maturity, when a customer is in payment shortfall or on their contractual monthly payment. When dealing with customers in payment difficulties, firms are not required to give regulated advice on any contract variations made to remedy payment shortfalls or arrears. However, MCOB 13 requires consideration of the individual circumstances of the customer, so it is good practice to carry out an income and expenditure assessment to check if the proposed new payment is affordable. If the customer is in payment shortfall or arrears on the interest-only payment, MCOB 13 applies in full both pre- and post-term end.

If the lender seeks to take possession on the basis of arrears, the mortgage pre-action protocol (PAP) will apply. The grounds for litigation/possession will be on the basis of arrears (rather than breach of contract). A judge will have the option of applying the Norgan[3] discretion if the mortgage is pre-maturity.

In contrast, a breach of contract event occurs once the mortgage term has expired, the borrower is up to date with interest payments, and the capital has not been repaid in full.

From a compliance perspective, most of MCOB 13 will not apply if the customer is up to date with interest payments but still in breach of contract. The provisions in MCOB 13 which relate to repossessions and sale shortfalls do apply.

Legally, the original contract, and terms and conditions, will continue post term-end, unless the contract is explicitly varied, or an alternative arrangement is agreed. However, if the lender fails to take action following the breach of contract, this may limit the way in which they can act thereafter. Therefore, where there is a lack of customer engagement and no alternative arrangement has been agreed, the lenders should only rely on the original contract for a short period of time.

Any changes or alternative arrangements should be clearly documented, and the customer should be explicitly notified as to what has been agreed and what has not been agreed and why. Where a new contract is agreed this will prevent action on the basis of the original breach of contract – unless a further breach occurs.

Any variation or concession to the contract will mean:

- The advised or execution-only rules in MCOB 4 will normally apply
- Where the variation involves a switch to a lifetime product, the relevant lifetime advice rules will apply
- An MCOB affordability assessment is required if the variation has a material impact on affordability (e.g. all or part of the mortgage is changed to a repayment basis or extends the mortgage maturity into retirement)
- Transitional arrangements can be used if the variation does not involve a further advance and the firm deems that it is in the customer's best interests to do so

If the lender seeks to take possession on the basis of breach of contract, mortgage pre-action protocol (PAP) will not apply. The grounds litigation/possession will be on the basis of breach of contract (rather than arrears).

Prudential issues

When forbearance raises issues for impairment provisioning

When provided with due care, arrears and forbearance support can be beneficial for firms and the customers, as it may reduce the number of repossessions and lower realised losses. However, where it is provided without due care, it can have adverse implications for the customer, the firm's understanding of the risks inherent within its lending book and, in turn, for the regulators and the market. The following paragraphs summarise the main points from the 2011 Finalised Guidance on Forbearance and Impairment Provisions and 2013 guidance on Dealing fairly with interest-only mortgage customers who risk being unable to repay their loan.

When providing forbearance, the FCA expects firms to have mechanisms for identifying impairments and potential impairment indicators. It is good practice to identify, report, and monitor all potential impairment indicators at all customer contact points across the firm. Firms should also ensure that internal and external reporting accurately reflect the loss risk assessment of forbearance and customer impairment.

The following are examples of potential impairment indicators:

- Where a customer requests a term extension to improve affordability
- Where a customer requests for payment holiday
- When a firm becomes aware a customer may not be able to repay the capital
- When the lender has provided the customer with a concession that it would not normally have provided had the impairment position of the customer not existed, for example:
  - Paying costs to support a voluntary sale of the property,

3 The Norgan discretion would allow for the entirety of the remaining mortgage term to be considered a reasonable timescale for repayment.

- Waiving of Early Redemption Charges (ERCs),
- Transfer to a reduced concessionary interest rate
- Not demanding capital repayment when repayment is due

If a lender becomes aware, during the term, that a customer's repayment strategy is insufficient (or is likely to be insufficient) to repay the loan balance at the end of the term, this may indicate a loss event has occurred. Whether a loss event has in fact occurred will depend on an assessment of what other viable arrangements to repay the loan can be put in place and, if those arrangements are not sufficient to repay the loan in full at the end of the term, whether there will be an impact on the estimated future cash flows.

Where a suitable solution for the repayment of the mortgage cannot be identified, the lender can seek possession of the property. It is good practice for the lender to document its efforts to contact the customer before commencing possession proceedings as the court may request them to verify the position of the lender. See above section on legal issues for a discussion on the grounds for litigation.

End of term accounting

The end of term accounting treatment for interest-only mortgages past term-end continues to be a key focus area with UK and EU regulators, and under the accounting rules that include IFRS9. We suggest all firms managing interest-only past term mortgages regularly review their internal end of term accounting policies against all relevant regulation and standards.

When loans are securitised

If the lender seeks to extend the term, change the loan to a capital repayment basis, or convert the customer to a retirement product, either before or after maturity, the lender should first seek clarity on whether the securitisation or covered bond arrangements allow such contact variation.

When loan is securitised or within a pool backing a covered bond, the options available for changing the terms of the contract may be restricted until the lender can buy back the impaired loan or it can be replaced in the security with a non-impaired loan of similar quality. Lenders may have different contractual requirements governing their securitisations and covered bonds and will need to bear in mind these obligations when establishing their policies for offering options to borrowers.

Reporting interest-only data to credit reference agencies

The following information is sourced from the Steering Committee on Reciprocity (SCOR) Data Quality Reference Guide.

Where interest-only mortgages reach the end of their term, the customer will be expected to pay the outstanding capital in full, thereby settling the account. If the customer is unable to settle the account, e.g. via a repayment vehicle, there are a number of options the lender may consider:

- Agree a new "capital plus interest" repayment mortgage over a new extended repayment period. This might just involve converting part of the shortfall on capital plus interest. Any such rescheduling should be assessed against existing credit policy and affordability criteria;
- Repossess the property, recover the debt, and default the customer;
- Extend the term of the repayment period, continue to allow the customer to pay the interest-only mortgage for the lifetime of the customer.

Should a permanent change in a loan's payment terms be agreed by the lender during the term of the mortgage, there will normally be a new agreement signed and the revised terms will be reported going forward. If a temporary change in the payment amount is jointly agreed between the borrower and lender, this will be recorded as an arrangement.

The three key financial fields that are provided as part of standard monthly updates are:

- Current Balance - total outstanding balance
- Repayment Amount - monthly payment amount
- Repayment Period - the term of the agreement in months

Reporting considerations relating to interest-only accounts:

- Once the interest-only term has expired, the repayment period should subsequently be provided as zero. The remaining two fields (Current Balance and Repayment Amount) should be updated as normal.

- Should the lender formally agree to extend the term of the interest-only mortgage, the new extended term should be provided.
- In the event of the mortgage being split between more than one product; e.g. part interest-only, part repayment, the repayment period should be reported based on the longest remaining active term and only recorded as zero once all parts reach maturity.

The 'status' of the account and potential arrears, should there be any, should be provided in line with current reporting practices, however consideration should be given to how such customers are treated, even more so, if they continue to meet the previous level of monthly payments. Prior to reporting these scenarios, lenders should consider a period of time to allow for any endowment funds to be made available.

Regarding cases where the lender takes possession:

- Defaults should be filed and dated as at the date of repossession. It may take a considerable time from litigation action to the point of repossession, so it is important to ensure that any adverse data is reported regularly to alert other lenders of the customer's financial difficulties.
- Should a property be repossessed and the sale results in a shortfall of the outstanding debt, the account should be defaulted for the amount still outstanding. Collection and recovery of this debt may still continue. The reported latest balance should be updated to reflect monies already recovered, with the remaining amount still outstanding.
- If the lender agrees to write-off the remaining balance, this should be shown as a Partial Settlement with a zero-outstanding balance.

PART 6: VULNERABILITY

If a customer is in or enters into vulnerable circumstances, whether financial, physical, mental, or other, this will impact their customer journey. While there is a need to deal sensitively with these cases there is also a clear need to balance conduct risk with prudential risk overall.

All firms should have their own overarching vulnerability policy which informs the approach to customers in such circumstances. Additionally, firms should also recognise that their interest-only policies may need to be flexed to take vulnerability into account.

Policies should be clear, consistently applied, and include reference to triggers for the identification of potential vulnerability (e.g. health, financial resilience, financial capability, life events) and to the appropriate recording and management of disclosures of vulnerability.

Lenders may choose to channel borrowers who are in in vulnerable circumstances towards a specialist customer service team, so they can be handled with appropriate sensitivity.

In some cases, borrowers may be best served bringing in a third-party to help them make financial decisions. This could be a family member or friend who is more financially sophisticated. However, customers can be embarrassed about their position and might not proactively seek help. Lenders may consider training customer service teams how to approach this subject in a sensitive and tactful manner.

Lenders may choose to channel borrowers who are in in vulnerable circumstances towards a specialist customer service team, so they can be handled with appropriate sensitivity. The 21 Steps Guide, produced by the University of Bristol's Personal Finance Research Centre may be a useful resource for working with indebted customers in vulnerable situations.

In February 2021, the FCA published Guidance for firms on the fair treatment of vulnerable customers. It sets out the FCA's view of what firms should do to comply with their obligations under the Principles and ensure they treat vulnerable customers fairly. This recommends that to understand the needs of vulnerable customers lenders should, among other steps:

- Understand the nature and scale of characteristics of vulnerability that exist in their target market and customer base.
- Understand the impact of vulnerability on the needs of consumers in their target market and customer base, by asking what types of harm or disadvantage customers may be vulnerable to, and how this might affect the consumer experience and outcomes.
- Embed the fair treatment of vulnerable consumers across the workforce. All relevant staff should understand how their role affects the fair treatment of vulnerable consumers.
- Ensure frontline staff have the necessary skills and capability to recognise and respond to a range of characteristics of vulnerability.
- Offer practical and emotional support to frontline staff dealing with vulnerable consumers.
- Set up systems and processes in a way that will support and enable vulnerable consumers to disclose their needs. Firms should be able to spot signs of vulnerability.
- Deliver appropriate customer service that responds flexibly to the needs of vulnerable consumers.
- Make consumers aware of support available to them, including relevant options for third party representation and specialist support services.
- Put in place systems and processes that support the delivery of good customer service, including systems to note and retrieve information about a customer's needs.
- Make sure all communications and information about products and services are understandable for consumers in their target market and customer base.
- Consider how they communicate with vulnerable consumers, taking into consideration their needs. Where possible, firms should offer multiple channels so vulnerable consumers have a choice.
- Implement appropriate processes to evaluate where they have not met the needs of vulnerable consumers, so that they can make improvements.
- Produce and regularly review management information, appropriate to the nature of their business, on the outcomes they are delivering for vulnerable consumers.

The full guidance can be found here.

PART 7: GLOSSARY OF TERMS AND ACRONYMS

Acronym buster

AVS: Assisted Voluntary Sale. See Glossary for definition

DTV: Debt to Value ratio

IFA: Independent Financial Advisor

IO: Interest-only

LTV: Loan to Value ratio

MP: Mortgage Prisoner. See Glossary for definition

PAP: Pre-Action Protocol. See Glossary for definition.

RIO: Retirement interest-only mortgage. See Glossary for definition.

RV: Repayment vehicle. See Glossary for definition.

SMI: Support for Mortgage Interest. See Glossary for definition.

Glossary

Advised sale: An alternative to an execution-only sale in which firms selling regulated mortgage contracts to or entering into variations of existing regulated mortgage contracts provide advice to the customer. MCOB 4.7A sets out standards to be observed by firms when advising a customer on regulated mortgage contracts.

Assisted Voluntary Sale: A scheme which may be offered by a lender to assist borrowers with exiting homeownership or downsizing.

Capital repayment mortgages, or repayment mortgages: a regulated mortgage contract under which the customer is obliged to make payments of interest and capital which are designed to repay the mortgage in full over the stated term.

Closed-book lender: a mortgage lender which no longer issues new loans.

Execution-only sale: an alternative to an advised sale where the firm does not give advice on home finance transactions to that particular customer seeking the loan. This can occur because the firm does not hold advice permissions or because the customer has rejected such advice given by the firm. See FCA Handbook for full definition.

Impairment: a financial asset is impaired when it can be recognised through objective evidence that one or more events have occurred which impact on the estimated future cash flows of the asset. In the case of mortgages, such events can include a breach of contract, such as a default, or delinquency in interest or principal payments. For more information, see the FCA's finalised guidance on Forbearance and Impairment Provisions – Mortgages.

Interest-only mortgage: a type of regulated mortgage contract in which the borrower only makes payments towards the interest on the amount borrowed over the term of the loan. At the end of the mortgage term the customer will still owe the full amount borrowed. See also definition in FCA Handbook.

Lifetime mortgages: a regulated mortgage contract which is not a retirement interest-only mortgage, under which:

a. entry into the mortgage is restricted to older customers above a specified age; and
b. the lender may or may not specify a mortgage term, but will not seek full repayment of the loan (including interest, if any, outstanding) until the occurrence of one or more of the specified life events; and
c. while the customer continues to occupy the mortgaged land as their main residence:
    i. no instalment repayments of the capital and no payment of interest on the capital (other than interest charged when all or part of the capital is repaid voluntarily by the customer) are due or capable of becoming due; or
    ii. although interest payments may become due, no full or partial repayment of the capital is due or capable of becoming due; or

- iii. although interest payments and partial repayment of the capital may become due, no full repayment of the capital is due or capable of becoming due;

  See complete definition in FCA Handbook.

Mortgage Prisoner: borrowers who are unable to switch to a new mortgage deal despite being up to date with their mortgage payments and, depending on their loan and borrower risk characteristics, could potentially benefit from switching.

Part & part repayment: A type of mortgage contract where the borrower pays off some of the loan principal throughout the term, but not all of it. When the mortgage comes to an end, there will still be some money left to pay off. Part and part mortgages are a middle-ground between repayment mortgages and interest-only mortgages.

Pre-action protocol: The Pre-Action Protocol for Judicial Review sets out a code of good practice and contains the steps which parties should normally follow before making a claim for judicial review. The Protocol encourages the parties to exchange information at an early stage and to consider using a form of alternative dispute resolution. Firms are required to follow pre-action protocol when making a possession claim on the basis of arrears.

Regulated mortgage contract

- a. (in relation to a contract) a contract which:
  - i. (in accordance with article 61(3) of the Regulated Activities Order) at the time it is entered into, meets the following conditions:
    - A. a lender provides credit to an individual or to trustees (the 'borrower'); and
    - B. the obligation of the borrower to repay is secured by a mortgage on land in the EEA, at least 40 per cent of which is used, or is intended to be used, in the case of credit provided to an individual, as or in connection with a dwelling; or (in the case of credit provided to a trustee who is not an individual), as or in connection with a dwelling by an individual who is a beneficiary of the trust, or by a related person
  - ii. is not a home purchase plan, a limited payment second charge bridging loan, a second charge business loan, an investment property loan, an exempt consumer buy-to-let mortgage contract, an exempt equitable mortgage bridging loan, an exempt housing authority loanor a limited interest second charge credit union loan within the meaning of article 61A(1) or (2) of the Regulated Activities Order; and
  - iii. if the contract was entered into before 21 March 2016:
    - A. at the time the contract was entered into, entering into the contract constituted the regulated activity of entering into a regulated mortgage contract; or
    - B. the contract is a consumer credit back book mortgage contract within the meaning of article 2 of the MCD Order.
- b. (in relation to a specified investment) the investment, specified in article 88 of the Regulated Activities Order, which is rights under a regulated mortgage contract within (a).

Repayment mortgage: a regulated mortgage contract

under which the customer is obliged to make payments of interest and capital which are designed to repay the mortgage in full 111 over the stated term.

Retirement interest-only mortgage: an interest-only mortgage which is not an interest roll-up mortgage and entry into which is restricted to older customers above a specified age. The lender is not entitled to seek full repayment of the loan until the occurrence of one or more of the specified life events (usually death or sale of property), unless the customer breaches their contractual obligations.

Securitisation: the financial practice of pooling various types of contractual debt (such as residential mortgages) and selling their related cash flows to third party investors as securities. Once mortgages are securitised, the originator of the loan no longer owns the beneficial interest in the loan, but may retain the legal interest, depending on the agreement.

Support for Mortgage Interest: A means-tested subsidised government loan to help individuals pay their mortgage interest.