CP20/13 Consultation on mortgages: Removing barriers to intra-group switching and helping borrowers with maturing interest-only and part-and-part mortgages

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Address: Mortgage Policy Team
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

Sent to: cp20-13@fca.org.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

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

As this is an optional measure, our members agree that this proposal should come into effect immediately after the Policy Statement is issued. However, it should be noted that firms will need some time to train staff and communicate any change in lending policy to their customers. As the FCA will be aware, lenders are currently managing the aftermath of mortgage payment deferral and preparing for the economic consequences of COVID-19. Therefore, firms may not immediately be able to take advantage of the new opportunities offer by the rules changes.

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

Lenders can see the rationale behind the proposed timeline but have concerns about the short turnaround period. Lenders are currently dealing with the additional administrative demands COVID-19 has created including working with those customers requiring and exiting payment deferrals. There is also the need to contact mortgage prisoners about the changes to affordability assessments prior to 1 December 2020. Informing customers of the proposed guidance could cause another spike in operational demand particularly for communications teams.

Lenders therefore will need some flexibility to stage their communications approaches by targeting the customers that are closest to maturity first.

Those borrowers with mortgages that have matured since 20 March 2020 will have already been contacted, in line with the communications strategies set out in the UK Finance Interest Only Toolkit. They will now need to be re-contacted as a matter of urgency. Their letters will need to be tailored to reflect how the updated guidance affects them retrospectively.

The guidance will expose customers to increased risk (see response to question 4). Firms will want to ensure that customers receive suitable mortgage offer documentation and warnings about the

risks of opting for a delay, for example, due to house price falls. With regard to the timeline, some firms will find the timescales very challenging to modify their systems, policies and train staff to communicate the risks, by the 31 October 2020 target date and we would request a period of up to three months from the date of publication for firms to be able to complete the communications to customers.

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

Lenders welcome the proposed changes as they will allow some customers to move to a more affordable product. Indeed, lenders proposed this amendment to the handbook. The industry voluntary agreement enabled customers on a reversion rate to move to a new mortgage, with 10% of qualifying customers taking up a new product with their existing lender and a further 6% moving to a new lender. A number of lenders have confirmed that they already have systems in place to allow customers to move products from one brand to another within a group structure. Other lenders have confirmed that they offer remortgages from within a closed book and will continue to do so. Lenders also welcome the decision to restrict the guidance to residential mortgages and not to apply it to buy-to-let or MCD exempt loans.

However, some closed book customers will be unable to move to another lender within a group. They may be in arrears, have a high LTV or have impaired credit and as a result may not be able to meet the lending criteria of the open books within a group.

Where lenders have securitised loans we do not expect them to be able to take advantage of the relaxations proposed by the FCA because each securitisation is funded by its own pool of investors, so a product switch between securitisations would result in a change in the beneficial ownership of the loan. Some more recent securitisations are structured so that customers can be offered a product switch and remain within the same securitisation – mortgage prisoners within these securitisations will already have been offered a product switch under the 2018 industry agreement. Customers in securitisations which are not able to offer a product switch could be helped in the longer term if rules or guidance were issued that all new securitisations (whether refinancing past securitisations or securitising new loans) should include provisions allowing for product switches within the securitisation.

We agree with the statement in section 3.11 that transfers should only be available to those customers who are not borrowing any additional money or making any change to the terms of the contract likely to be material to the affordability of the loan. Most lenders will not allow product transfers where the customer is moving home without a full income and expenditure assessment. The industry voluntary agreement which allowed most existing customers on a reversion rate to secure a new deal was limited to customers who were not moving as the lenders did not conduct an income and expenditure assessment. However, the proposed amendment to the FCA Handbook at MCOB 11.6.3 (R) 1 (aa) goes beyond that. It will allow someone to port the mortgage to a new property. Following a move, lenders expect customer's income and expenditure profile to change. It also means a change in the underlying security for the mortgage. Therefore, we would ask that this is **reconsidered.** We recommend that **the ability to move to a new mortgage within a group is restricted** to those customers who do not want to borrow any more money (other than arrangement fees), add or remove any borrowers to the contract or port it to a new property.

We welcome the statement in section 3.12 that lenders can choose to use the additional flexibility. This will enable them to lend according to their risk appetite and business model. As the intra-group switching proposal as consulted on is optional, there should be no expectation on firms to use it. It must be firms' commercial decision as to whether they use it or not. The availability or otherwise of follow-on products for existing customers from within the closed book should not affect the expectations of the FCA or the Financial Ombudsman Service (FOS) on the use of this proposed rule.

Section 3.14 asserts that the rule change "should not require significant system changes". Lenders have noted that many of the closed books operate on legacy systems that have not been amended as they are being wound down. The transfer of a customer from a legacy system to the main operating system for an active brand will require considerable changes or a manual process. In the light of the pandemic and its economic consequences, lenders are prioritising improvements to their active systems. These will improve the customer experience for more customers than making amendments to legacy systems which will benefit far fewer customers.

It should be noted that if customers switch they may be subject to additional charges such as legal and arrangement fees. For a number of firms, a re-mortgage will be required to move the customer from one system to another and firms may be reluctant to bear the extra costs. Alternatively, firms may have to design specific products for these customers which cover the cost of fees that would normally be paid by the customer as part of a re-mortgage, therefore offering products with higher rates to those offered to customers already on the active lender's book.

In order to manage expectations of customers, the FOS and other stakeholders, the communication of the change to the rule book needs to be handled carefully. If a customer is in a closed book within a group but does have access to new deals within that book, our understanding is that the lender does not have to offer a move to loans in the wider group. There is widespread confusion about customers who are a higher credit risk, including those that are interest only, or have a high LTV and a lack of appreciation that such customers cannot expect to be eligible for the very lowest rates that are available from a lender or the wider market. Not all lenders will have a product in their main range which would be suitable for their closed book customers. This is particularly true where lenders have historic second charge lending in closed books but do not offer new second charge loans at all. Stakeholders need to understand that there is no automatic right to a new mortgage for closed book customers within an active group. We would be happy to work with the FCA to develop a communications strategy around this rule change.

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

General approach

Lenders agree with the general principles outlined by the guidance. In most cases lenders are already providing greater support to customers who go past maturity than is stipulated by the proposed guidance. We developed a specific section of our Payment Deferrals FAQs to address the issues of supporting interest only customers. The FCA are aware of the industry approach of treating these customers sympathetically.

Our members adhere to the UK Finance Interest Only Toolkit which provides practical tools and best practice guidance for providers of interest-only mortgages. This toolkit aims to prevent

unnecessary customer detriment and has resulted in lenders providing additional time for customers to settle their mortgages after original maturity.

Although lenders are already aligned with the guidance in their own current policies and conduct, they have substantial concerns regarding the proposed guidance, particularly if customers can delay repayment of their capital for reasons other than affordability.

We understand that the guidance only applies to regulated residential mortgages and so it will not apply to loans made under the Article 3(1)(b) exemption or to unregulated Buy to Let mortgages. While we do not represent bridging loan lenders, some of our members offer them alongside first and second charge mortgages, so they are also interested in whether bridging loans are included in the guidance. These loans are generally very short term and we would welcome clarification that where the loan has a term of less than one year the guidance does not apply. We would also welcome clarification on the application to non-exempt MCD Article 3(1)(b) loans. The intention of the guidance is to ultimately avoid the risk of repossession or negative property equity, as Article 3(1)(b) loans are by definition not secured over the residential property we would expect the guidance to not apply to loans of this nature.

Lenders have noted that high net worth (HNW) customers normally have very short mortgages, typically lasting around 5 years. The value of loans to high net worth customers is substantially higher than the average set out in the consultation paper. HNW lenders have a close relationship with their customers and will consider a wide range of investments and sources of funds in a wealth management portfolio as well as the mortgage. Self-certification would be a substantive change in that relationship. Whilst lenders would of course seek to support HNW customers who are exposed to the risks set out in the consultation paper we do believe a more tailored approach would be appropriate for these customers considering that risks around re-mortgaging will not be as prevalent and the greater complexity of these customer's circumstances and financial resources.

Lenders would welcome flexibility in deciding whether any term extension is formalised in a new contract (which would require a new ESIS) or an informal arrangement agreed without a new contract. Different lenders currently take different approaches and they would like to continue with their current working practices.

Decision making responsibility

The primary concern is how the guidance will operate in terms of who, the customer or the lender, has decision making powers. Payment deferrals, in response to COVID-19, operate on an entirely customer, self-certification basis. Lenders are unable to refuse customers this forbearance even if they are able to evidence the fact that a customer did not have their income impacted by the pandemic and would actually be costing themselves more money than necessary by receiving a deferral. The Bank of England has estimated that some 30% of payment deferrals were taken by households that had seen no reduction in their income.

If a customer takes a payment deferral when it is not strictly required, that alone will normally only result in a limited degree of detriment. However, delaying the settlement of a mortgage could be far more detrimental for some customers if it is opted for unnecessarily. The main issue is that, if customers are able to entirely self-certify their need to delay settlement, they will be opening themselves to the risk that their settlement vehicles may not cover the full amount of their mortgage and may decline in value during the period of delay.

Recent macroeconomic data has revealed the depth of the economic consequences of COVID-19. In this climate, customers may feel their homes or other settlement vehicles have fallen in value but may increase in value over time. Even if the customer can pay their settlement there is the risk that they wait until a later date, in the hope that the value of their investments, improve. Lenders are concerned that market conditions are unpredictable and so customers deciding to postpone settlement are at greater risk of experiencing losses.

This is likely to be particularly true for those intending to settle their capital repayments using the sale of their homes. At present the housing market is buoyant and those selling properties in to settle the mortgage may benefit from price rises associated with the reduced stamp duty rates in place until the end of March 2021.

The lender will need to explain the increased risk of delay to customers. If, however, the decision remains solely customers' responsibility lenders will be powerless to ensure the potentially detrimental outcomes are avoided, even if they can be foreseen. Lenders will also face the risk of complaints when, with the benefit of hindsight, customers are able to see that their decision (whether it was to delay or repay on maturity) has resulted in a detrimental outcome.

A risk of further detriment is posed by the fact that, by deferring a final payment, the customer will pay more in interest to the lender. Lenders will also need to explain this to the borrower. A lender would normally advise that customers settle their mortgages as soon as possible to reduce the cost to the customer but again, the ability to influence this will be lost if the guidance dictates self-certification.

As a result, lenders think it is important that the guidance is repositioned to make it clear that customers continue to be required to repay their loan at maturity but that litigation action will not be taken before October 2021 where they are unable to do so and engages with their lender about their repayment difficulties. This is a key point that needs to be decided urgently as it will substantially change the nature of the communications that firms need to develop and the staff training that needs to be undertaken.

Allowing customers to delay for reasons other than affordability increases the importance of communications with customers in terms of properly informing them of the risk of delaying settlement. and the challenges in developing such communications and training staff appropriately. As highlighted in response to question 2 the timeline for adjusting these communications is limited and flexibility from the regulator over the timing of communications to different cohorts of customers would be needed. We urge the FCA to set out their communication plan for the change so that lenders can be ready with their communication and training strategies and can update their customer websites in time for the communication.

Interest Rates

Lenders agree that customers should not be subject to unfair interest rate increases as a result of a delay of settlement. Most firms do not to apply penalty rates, although there are some loans which are fixed for the term of the loan and have been priced accordingly. However, there is a risk that lenders will be unfairly impacted if they are forced to extend offers that were previously contingent on an end date. We believe the FCA's existing rule in MCOB 2.6A-1 addresses this point adequately.

For some mortgage products the consumer's revert rate will start at the point of product maturity. This has been explained to the borrower at the outset of the mortgage. It would therefore be fair, in these cases, to charge the applicable revert rate throughout any delay in capital repayment past maturity.

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

Lenders generally agree that it is a reasonable approach to target up-to date customers, but flexibility and discretion should be encouraged in the guidance as most lenders operate this way currently. There are two particular cohorts that need to be considered when adopting the guidance.

The first is customers who had a small amount of arrears that would have likely been covered by their existing exit strategy. These customers do not require additional support from the lender than those customers who are up-to-date. These borrowers should be able to access the additional allowances outlined by the guidance.

We estimate that around 2% of customers who will reach maturity within the guidance's time frame are in a month or greater amount of arrears. This amounts to around 1,800 customers in total. Firms are likely to be able to have the capacity to show discretion in these cases and would in practice offer forbearance to such customers if they needed more time to repay the outstanding loan balance but were able to continue to pay interest in the interim.

The other customers to consider are those who were up-to-date but have had their incomes impacted and will not be able to maintain their interest payments. These customers are in the unique position of potentially being best served by settling their capital payments of their mortgage sooner rather than later.

The interest-only toolkit, again, sets out best practice but firms will adopt approaches on a case by case basis and treat customers fairly. Lenders are keen to be sure that the FCA is satisfied with a case by case approach for customers who are up-to-date, have suitable exit strategies but have seen medium to long-term impact on their income and ability to repay their interest due to COVID-19.

Where customers are not engaging with their lender, firms will be limited in the forbearance that they can apply. As there is a moratorium on court proceedings, if borrowers do not engage with their lenders, they will be exposing themselves to increased debt without the lender being able to step in. The guidance should encourage borrowers to contact their lenders at the earliest opportunity and state that if the borrower does not contact their lender before maturity an extension to the mortgage cannot be guaranteed.

Lenders require further clarity on dealing with unresponsive customers, who are clearly being exposed to greater detriment by delaying repayment of their capital. Lenders would welcome examples of acceptable approaches to be clearly indicated in the guidance.

Some lenders also currently face restrictions on their ability to extend mortgages because of their securitisation requirements and funding structures. Lenders who serve high net worth clients face particularly steep challenges in this regard as their terms tend to be shorter and the value of the settlement amounts larger. For these lenders, a large proportion of extensions within the same 12-month time frame could result in unmanageable capital constraints.

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

Lenders see 12 months as a reasonable timeframe to offer the additional allowances. Lenders do however see there being potential pitfalls in implementation. Communications with customers by policy-makers, the regulator and industry must be aligned. The key messages are that customers should continue to engage with their lenders throughout the period and they should settle if and when they can afford to.

Most lenders would contact customers who have mortgages maturing in October six months in advance, i.e. by the end of March of that year. It is essential that customers are not left with the understanding that they need not think about their mortgage for another year and this message should be included in the guidance.

The rigidity of the timeline also presents potential issues, particularly at the end point, 31 October 2021, when a large number of Letters before Action are likely to be sent and three months later when repossessions proceedings will coalesce. The operational demands on firms during these key periods may again present some difficulty.

Where the customer has a part and part mortgage, if the IO part is the minority part the customer could continue to pay the IO element but fall into arrears if they do not make full contributions on the repayment mortgage element. Under these circumstances the lender should be able to continue collections activity.

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

The CBA provided is more comprehensive than we have seen previously which is welcomed. The causal chain looks reasonable and reflects the opportunity that would be provided by the rule change. However, lenders are concerned that the CBA does not properly reflect the costs of dealing with the limited number of customers who may be eligible for a move to a new product.

The costs included in paragraph 22 are an underestimation of the cost of compliance. There is more to be included than the cost of reading documents (for example, a review of the proposed rules by legal teams, the cost of responding to initial customer inquiries about their eligibility, the cost of responding to complaints and the implications of a complaint to FOS).

The costs associated with systems change are similarly underestimated. As the changes are most likely associated with legacy systems the costs will be higher than those associated with maintaining an active book.

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

Lenders were concerned that the cost estimates may be too low.

There is a view from lenders that administrative costs, including providing revised estimates have not been properly factored into the CBA. The costs of complying with the guidance will be higher if the guidance simply allows customers to delay repayment of their capital at maturity. If the

guidance states that litigation will not be pursued before October 2021 if they maintain their interest payments, the policy intention will be achieved at a lower cost. A whole suite of new communications and staff training will be required to articulate and mitigate the risks to customers of delaying repayment of their capital under the guidance as drafted. Whereas providing assurance that litigation will not be pursued could be achieved with more incremental change to existing communications and staff training. The likelihood of increased complaints, from customers who feel they have been negatively impacted by opting for a delay (or choosing to pay at maturity), should also be considered unless the customer's right to choose is removed.

The financial cost to firms will depend on whether the term extensions are deemed to be carried out under forbearance. Firms seek clarity on this point. If they are, under the EBA's July 2019 guidance on the management of non-performing and forborne exposures and under IFRS9 and recent PRA guidance (PS 11/20 May 2020), firms will be required to hold significantly higher provisions for the potential large cohort of IO past term mortgages that are given a formal term extension that may be classified as a non performing loan.

If you have any questions relating to the response to questions 1, 3 and 7, please contact Sue Rossiter, Principal, Mortgage Regulation (sue.rossiter@ukfinance.org.uk) all remaining questions should be referred to Lorence Nye, Manager, Mortgages (lorence.nye@ukfinance.org.uk).

Charles Roe
Director, Mortgages