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Trapped Borrowers and UK Asset Resolution

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HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Nicky Morgan MP
Chair of the Treasury Select Committee
House of Commons
London
SW1A 0AA

12th November 2018

Dear Nicky,

Trapped Borrowers and UK Asset Resolution

During my testimony on 30 October, I promised to write to the Committee to set out the Government's position on "mortgage prisoners", and Tom Scholar committed during his testimony on 24 October to write on the same issue and customer treatment in the context of UK Asset Resolution (UKAR) sales. This letter sets out the Government's position on these issues and covers the issues the Committee raised both with me and with Tom Scholar and Charles Roxburgh.

Trapped Borrowers

I agree wholeheartedly that borrowers who find themselves unable to access cheaper mortgage deals are in a difficult and stressful situation.

While it is right and sensible that regulation since the financial crisis has put an end to the poor lending practices of the past, better deals should not be beyond the reach of customers who are continuing to pay their mortgage. That is why, as part of the reforms to mortgage lending introduced by the Financial Conduct Authority's (FCA) 'Mortgage Market Review' (MMR) in April 2014, lenders were able to waive affordability requirements for new and existing customers that were remortgaging but not increasing the size of their debt. These exemptions were put in place to help existing borrowers who had taken out large mortgages and may have found it more difficult to remortgage under the new rules.

Unfortunately, the European Union's (EU) Mortgage Credit Directive (MCD), which came into force in March 2016, formally prevents lenders from waiving the affordability requirements when a borrower moves to a new lender. As the UK is required to comply with the conditions contained in the MCD, the exemptions put in place under the MMR can no longer be applied in circumstances where a borrower moves to a new lender.

While we must comply with the MCD, the FCA took advantage of the flexibilities it had under the Directive to ensure that lenders can continue to waive affordability requirements for existing customers that are remortgaging but not increasing the size of their debt. The former Chancellor wrote to the CEOs of every major UK mortgage lender in May 2016 making clear how important it was that lenders were taking advantage of this exemption and that customers were able to access the best deals on offer at their existing lender. In 2017, the Financial Policy Committee also clarified that its recommendation for lenders to test a borrower's ability to repay a mortgage

should interest rates increase by at least 3% did not apply to customers who are remortgaging and not increasing the size of their loan. Following on from this, in July 2018, UK Finance, the Building Societies Association, and the Intermediary Mortgage Lenders Association, announced a cross-industry voluntary agreement to help 'mortgage prisoners'. Under the agreement, which 67 authorised lenders representing 95% of the UK's residential mortgage market have signed up to, lenders have undertaken to write by the end of 2018 to any borrowers on the reversion rate who are up to date with payments, and have a minimum of 2 years and £10,000 left on their mortgage, to let them know they can switch to a better deal with their existing lender.

While this action has improved the position of borrowers with active lenders, I agree that more still needs to be done to help those who have mortgages with inactive lenders. I have made clear to my officials, as I set out in my responses to the Committee on 30 October, that exploring solutions for these customers is a top priority. That is why officials are working closely with the FCA who are exploring what more could be done as part of their Mortgage Market Study. It is also why if necessary the Government is prepared, once it is able to amend the repatriated Mortgage Credit Directive, to explore legislative solutions.

I also promised to keep the Committee informed as the work on this issue progressed. I will write again to update the Committee when I have progress to report.

In the meantime, I recognise that some borrowers find themselves in difficult circumstances. Borrowers should be aware that the FCA has rules in place to protect existing customers who find themselves unable to remortgage. These rules prevent lenders from taking advantage of the customer's situation, or treating them less favourably than similar customers, for example, by offering less favourable interest rates or other terms. Customers who find themselves in this position and feel they have been treated unfairly may make a formal complaint to their lender. If they do not feel their complaint has been dealt with satisfactorily, they are able to refer the matter to the Financial Ombudsman Service (FOS).

Borrowers facing financial difficulties may also find it helpful to speak to Citizens Advice. Citizens Advice helps people resolve their legal, money, and other problems by providing independent and confidential advice. They provide advice through face-to-face, telephone and email services, and online via their self-help website: www.citizensadvice.org

UKAR customer treatment

I would like to reassure you that UKAR and the Government place the utmost importance on treating customers fairly. Both NRAM Limited and Bradford & Bingley (B&B) are regulated by the FCA, comply with the principles of Treating Customers Fairly (TCF), and their customers can complain to the FOS if they believe that they have been treated unfairly.

Since nationalisation, B&B and NRAM have been subject to State aid restrictions imposed by the European Commission that prevent them from offering new loans or products, and restricts their discretion when setting their Standard Variable Rate (SVR). These conditions were necessary for the Commission to approve the State aid provided to B&B and Northern Rock in 2008 as part of the interventions to protect the UK financial system.

As the Committee is aware, UKAR was established in 2010 to facilitate the orderly management of the closed mortgage books of both B&B and NRAM and to maximise value for taxpayers, whilst ensuring that both B&B and NRAM continue to treat customers fairly, deliver consistently high levels of service and support those customers who are facing financial difficulty. As part of this work, UKAR has reduced the operational capacities of both entities to reflect their limited business roles and facilitate their eventual wind-down. UKAR has not had the capability to design, provide

and manage new products in line with the requirements of the FCA as this capability remained in the private sector.

Committee members asked why UKAR's SVR is "three times the best rate available on the market". I believe this statement compares UKAR's SVR with fixed rate products, which B&B and NRAM are unable to offer their customers. UKAR's ability to set its SVR is constrained by the State aid conditions imposed on NRAM and B&B. UKAR sets its SVR with reference to the SVRs of the top 15 UK mortgage providers. This ensures that UKAR's SVR is in line with other variable rates available in the market. The State aid requirements prevent UKAR from setting a rate that is more competitive than the majority of other lenders.

UKAR also encourages customers to remortgage with other providers, if they are able to do so. UKAR helps customers find better deals elsewhere by:

- proactively contacting customers they believe may be able to access better deals with other lenders;
- waiving all Early Repayment Charges for customers that wish to (i) move to another provider, or (ii) redeem their loan with B&B or NRAM; and
- providing an online 'Deal Finder' tool that allows customers to search the market to find and compare mortgages from other lenders.

As well as the above, UKAR partners with Mortgage Force, who have a panel of brokers who can give impartial, whole-of-market mortgage advice. UKAR also refers its customers to HUB Financial Solutions for specialist equity release advice. Fees relating to these services are waived for customers referred to these organisations by UKAR.

UKAR asset sales

The Government has announced its intention to return the assets acquired in 2008 to the private sector, subject to market conditions remaining conducive and achieving value for money. Significant progress has been made to date, with the Government's shareholding in Lloyds Banking Group completely divested, sales of Royal Bank of Scotland shares in 2015 and earlier this year, and UKAR's balance sheet having been reduced from approximately £116 billion at formation to £19.8 billion as at 31 March 2018. Sales of B&B and NRAM mortgage assets are an important contributor to this balance sheet reduction. The remaining sales will bring to a close two of the major financial sector interventions of 2008 and recover significant value for the taxpayer.

While it is important to maximise value for taxpayers in these sales, a key consideration for UKAR and the Government is customer treatment. As has been the case in all previous UKAR asset sales, bidders in future UKAR sales will be required to agree to UKAR's customer treatment conditions in order for their bid to be considered. This is a strict requirement, not open to negotiation, and is considered before bids are assessed on price.

These protections have varied from transaction to transaction, reflecting the idiosyncratic characteristics of the assets in question, but key protections in all mortgage assets sales have included:

- adherence to the FCA's principle of TCF;
- requiring that the loans are administered by an FCA-regulated company;
- not changing the terms and conditions of any of the loans that are sold; and

- where customers are on SVR mortgages, restricting the changes purchasers can make to the SVR for 12 months after the transfer of ownership.

Committee members asked what lessons could be learned to improve future sales. UKAR and HMT are working closely with the FCA to determine what customer protections should be put in place for the remaining UKAR asset sales.

In the case of the sale to Cerberus Capital Management (“Cerberus”) in 2016, Cerberus agreed to the customer protection conditions set out by UKAR and were the highest placed bidder. Any plans Cerberus may have had to become an active lender in the UK were not assessed in the ranking of their bid. Accordingly, UKAR and the Government did not seek a formal commitment from them that they would become an active lender.

Landmark Mortgages, the subsidiary of Cerberus that manages the mortgages on their behalf, is – like NRAM and B&B – regulated by the FCA, must comply with TCF principles and Mortgages and Home Finance: Conduct of Business (MCOB) rules, and customers can complain to the FOS if they believe they have been treated unfairly.

I think that it is important to stress that selling B&B and NRAM loans to inactive lenders does not impact customers’ ability to remortgage elsewhere. B&B and NRAM are unable to offer new products, and this will remain the case until both institutions are completely wound up. However, as set out above, I am committed to exploring solutions which will benefit customers with NRAM, B&B or other inactive lenders.

In conclusion, I want to reassure the Committee that I share their concerns about this problem and have instructed my officials to continue exploring potential solutions. I will update the Committee as soon as I have progress to report.

with very best regards

John

JOHN GLEN