FINANCIAL CONDUCT AUTHORITY

Mortgage Prisoners Review

November 2021

CP 576

Mortgage Prisoners Review

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Presented to Parliament by
the Economic Secretary to the Treasury by
Command of Her Majesty

November 2021

CP 576

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1 Scope of the Review

1.1 In April 2021, the Economic Secretary to the Treasury (EST) announced that the Treasury would work with the Financial Conduct Authority (FCA) to look in more detail at the characteristics of mortgage prisoners. The EST also said that we would review the effect of our recent interventions to remove regulatory barriers to switching for these borrowers. These two interventions are the modified affordability assessment and our intra-group switching rule change.

1.2 This paper and supporting analyses meet our commitment to provide the Government with our Mortgage Prisoners Review. The Government and industry, with support from regulators, have committed to working together (including seeking further engagement with inactive firms) to look for practical and proportionate solutions to help as many affected borrowers as possible switch to an active lender, should this be the customer's wish. The purpose of this Review is to inform this.

1.3 We published the Terms of Reference for our Mortgage Prisoners Review in July 2021. This set out the steps that we said we would take.

1.4 The Review includes the following:

- A summary, for context, of the reported characteristics of the wider population of borrowers and mortgages in closed books with inactive firms compared to reported characteristics of borrowers and mortgages with active lenders (Annex 1)
- An up-to-date estimate of the number of mortgage prisoners in closed books with inactive firms and their loan and borrower characteristics (Annex 2)
- A review of our recent actions to remove regulatory barriers to switching to make it easier for lenders to lend to mortgage prisoners. These are the modified affordability assessment and the intra group switching rule (Annex 3)
- A summary of the background to the issue of mortgage prisoners (Annex 4).
- A breakdown of the data gathered from mortgage intermediaries (Annex 5)

1.5 The Review focuses on the mainstream first charge residential mortgage market. Buy-to-let, second charge mortgages and lifetime mortgages are not part of this Review.

1.6 This Review is based on regulatory reporting data from firms on the status of mortgages at 30 June 2021, credit referencing data and qualitative evidence from key stakeholders. These stakeholders include consumer groups, mortgage prisoner advocates and industry. We would like to thank all stakeholders for sharing their data, feedback and experiences.

1.7 Government and industry will use this Review to consider if there are further practical and proportionate solutions that will enable borrowers to switch their mortgage where they would benefit from doing so. We will continue to provide any necessary regulatory assistance to support Government and industry with this.

2 How the mortgage market works

2.1 There are around 8.5 million residential mortgages in the UK (not including buy-to-let, second charge or lifetime mortgages). Most mortgages sold in the UK have an introductory deal for a fixed period (typically at a fixed interest rate). After this expires the rate changes to another (reversion) rate, which may be a Standard Variable Rate (SVR) or one linked to a benchmark rate such as the Bank of England Base rate. Moving to a reversion rate can mean an increase in interest rate, and mortgage payments. So, it can be in a consumer's interest to switch to a new deal either with their existing lender (internal switch) or with a new lender (external switch or remortgage).

2.2 Lenders offer different interest rates based on their assessment of the risk that a borrower will not be able to repay their mortgage. This 'pricing for risk' means the greater the risk of non-repayment, the higher the interest rate. Importantly, when pricing for risk a lender will still need to assess whether the mortgage is affordable and only lend where they decide that it is.

2.3 The lowest rates are offered with the largest fees. So a borrower will benefit from switching if the savings in monthly payments from paying a lower interest rate outweigh any fees payable. Or borrowers may benefit from greater payment certainty by switching to a more expensive interest rate to fix their payments.

2.4 Switching levels are high in today's mainstream mortgage market; there are a range of products on offer and there is apparent competition on headline rates between lenders. In a market that works well, borrowers should be able to switch to a new deal that meets their needs at an interest rate that fairly reflects their credit risk.

2.5 Lenders consider it too risky to lend to some borrowers because of their characteristics or the characteristics of the loan (such as the mortgage loan-to-value (LTV), a borrower's proposals for repaying capital on an interest-only mortgage, or a borrower's credit record). These borrowers cannot get a new mortgage or switch to a new deal.

2.6 Existing borrowers can find that their mortgage characteristics fall outside lender risk appetite for two reasons – their circumstances change or lender risk appetite changes. If a borrower's circumstances change, they can find that their loan and borrower characteristics mean they then fall outside the risk appetite of lenders. Or the price for the risk they present may have gone up on top of any general increase in interest rates caused by market conditions.

2.7 In 2008, due to the financial crisis, there was a shift in lender risk appetite in the mortgage market. This resulted in a number of borrowers who took out their mortgage in 2008, or earlier, finding that their loan and borrower characteristics no longer met the risk appetite of lenders. For example, where the amount they borrowed was greater than the value of their property or where they had an interest-only mortgage with no strategy to repay the capital borrowed. This meant that, despite being up to date with their mortgage payments, they could not switch to a new mortgage.

2.8 In 2018, following our Mortgages Market Study, most active lenders committed to offering their existing borrowers new deals providing they were up to date with payments (see Annex 4 – background). This means that customers of these lenders, who otherwise might be unable to switch, can usually get a new deal from their existing lender. But firms that are not active in the mortgage market are not party to this commitment and do not offer new deals to existing borrowers. So, we have removed barriers to switching to help borrowers by introducing the modified affordability assessment and intra group switching rule. These make it easier for active lenders to lend to borrowers who cannot otherwise switch. However, we cannot force lenders to lend to any borrower and who to lend to is always a commercial decision for firms.

3 Who is a mortgage prisoner?

3.1 We define a **mortgage prisoner** as a borrower who is up to date with payments and:

- is unable to switch to a new mortgage deal (with a new lender or with their existing lender) and
- could potentially benefit from switching depending on their loan and borrower risk characteristics.

3.2 We include the second part of the definition because lenders price mortgages based on credit risk. So when we assess whether a borrower who cannot switch is a mortgage prisoner, we consider how likely it is that they would be able to switch to a cheaper deal, given their loan and borrower characteristics, if they could switch. We consider the rate they pay and do not classify those paying low rates for their circumstances, as mortgage prisoners.

3.3 Some stakeholders define mortgage prisoners differently to include a wider group of borrowers. To give context and as complete a picture as possible for stakeholders we include data on our estimate of the number of borrowers we assess can and cannot switch. We also explain how we narrow the population of closed book mortgages with inactive firms to those we define as mortgage prisoners. This includes removing those who are not up to date with payments and those who are near the end of their mortgage.

4 Mortgage prisoners are most likely to have a mortgage with an inactive firm

4.1 An inactive firm is either a lender that no longer lends to new customers (an inactive lender) or they are not a lender and may not be regulated by the FCA. Some inactive firms are those who were previously lenders and that have failed or otherwise left the market. The population of closed book mortgages with inactive firms is the focus of our analysis. This is because:

- Mortgages with active lenders are more likely to have been taken out after lender risk appetites tightened and as a result, these borrowers are more likely to be able to switch in the open market. Mortgages in closed books with inactive firms are more likely to include mortgages taken out in 2008 or earlier, before lender risk appetites and regulatory expectations tightened after the financial crisis.
- Active lenders (covering 97% of the market) will offer a new deal to existing customers who are up to date with payments as part of a voluntary industry agreement. So, even if a customer's circumstances have changed so that they cannot switch lender, in most cases they can still get a new deal with their existing lender. Inactive firms do not offer their borrowers new deals so these borrowers cannot get a new deal if they cannot switch to a new lender.
- Our intra-group rule change enables active lenders to offer new deals to borrowers in closed books within the same financial group. We consider the effectiveness of this rule change in Annex 3 of this Review.

4.2 So, while there may be some mortgage prisoners who have mortgages with active firms, the vast majority will have a mortgage in a closed book with an inactive firm. Therefore we focus our analysis on the population of mortgages in closed books with inactive firms. We have assessed both the characteristics of the population of closed book mortgages with inactive firms more generally, and specifically the number and characteristics of 'mortgage prisoners'.

5 Our interventions

5.1 The following measures have been introduced to reduce barriers to switching:

- In July 2018 active lenders, covering around 97% of the active market (or about 8m mortgages), agreed to give existing residential mortgage customers on a reversion rate the option to move to another deal, if they meet certain criteria such as being up to date with payments.
- In October 2019, we changed our rules to allow lenders to use a modified affordability assessment for borrowers who were up to date with payments to enable them to switch to a more affordable mortgage.
- We required inactive lenders and regulated administrators acting for unregulated entities to contact borrowers, by January 2021, to let them know it may be easier to switch as a result of the modified affordability assessment rule change. These firms also had to signpost these borrowers to sources of information about how to switch using these rules.
- In October 2020, we changed our rules so that active lenders no longer have to make an affordability assessment when they offer a new deal to borrowers in closed mortgage books of a lender in the same financial group. This is as long as these borrowers meet certain criteria, such as there being no overall change that materially affects the mortgage's affordability.

6 Findings

6.1 Our findings are set out below:

Characteristics of closed book mortgages with inactive firms

6.2 As of 30 June 2021, there are around 195,000 mortgages in the population of closed books with inactive firms. This population has reduced from around 250,000 in 2019 and now represents 2.3% of the total number of residential mortgages. Not all of these borrowers are trapped – many could switch. Due to account closures this population has reduced by 20,486 (10%) in the first half of 2021 with the borrowers of over 2,000 mortgages switching to a new lender. Currently:

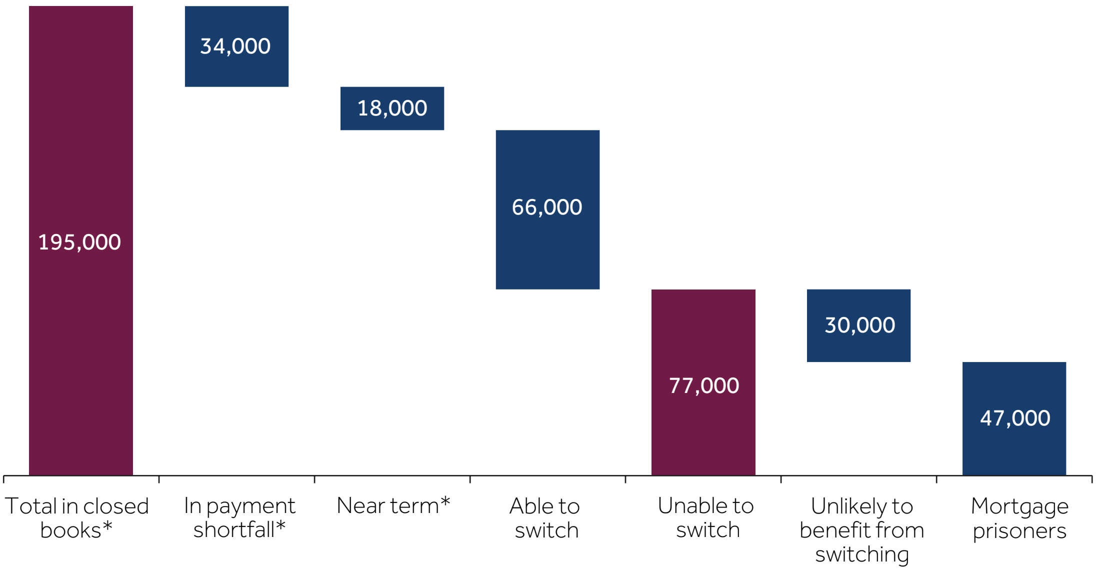
- 97% of the closed book mortgages in our analysis were originated in the pre-financial crisis period up to 2008, This compares to 19% of mortgages with lenders active in the mortgage market.
- 94% of the closed book mortgages are on variable rates. This includes 36% on a standard variable rate, 30% on a base rate tracker, and 27% on a LIBOR tracker. 73% of mortgages in the active market are on fixed rates, with 13% on a standard variable rate and 10% on a base rate or LIBOR tracker.
- 50% of borrowers in closed books with inactive firms pay a current interest rate of 3% or less. 47% (around 91,000) pay interest rates of between 3% and 5%. 3.3% (around 6,000) pay an interest rate of more than 5%. In contrast 82% of borrowers who have mortgages with lenders in the active market pay a current interest rate of 3% or less, 17% (around 1.4m) pay interest rates of between 3% and 5% and 0.8% (66,000) pay an interest rate of more than 5%.
- 95% of closed book mortgages with inactive firms have a lower interest rate than at origination.
- Closed book mortgages tended to have certain higher risk characteristics than 'active book' mortgages at origination. For example, 46% did not provide evidence of income when they took out their mortgage compared with 11% of active book mortgages, and 20% borrowers had impaired credit when they took out their mortgage, compared with under 1% of active book mortgages.
- Closed book mortgages are also more likely to currently display higher risk characteristics than active book mortgages. For example, 17% have a current mortgage payment shortfall (compared to 2% in active books) and 53% are interest-only (compared to 9% in active book mortgages).
- There isn't a link between the interest rate paid and the incidence of payment shortfalls when looking at the distribution of closed book mortgages with a current payment shortfall. So, those borrowers in closed books with inactive firms who pay higher interest rates are not more likely to be in payment difficulty, compared to those who pay lower rates.
- In Annex 1 we set out the number of mortgages in each of the different 'segments' within the closed book mortgage population (by loan-to-value, age of main borrower, remaining term, interest rate and repayment type – and whether those mortgages do or don't have a payment shortfall).

The number and characteristics of mortgage prisoners

6.3 Within the inactive firm closed book population (195,000), we estimate that there are **47,000 mortgage prisoners** (24% of the closed book population). This is based on a sample of mortgages in the population of mortgages in closed books with inactive firms that is matched to a random sample of credit reference agency data. We have verified that the sample of mortgages has similar characteristics to the population, so we can make statements about the population from what we observe in the sample.

6.4 Figure 1 shows how we arrive at our estimate of mortgage prisoners.

Figure 1: Closed book mortgages and mortgage prisoners



*These figures are taken from the analysis at Annex 1

6.5 To estimate the number of mortgage prisoners we remove the following groups of mortgages from the closed book population of 195,000 mortgages (see Annex 2 and its Appendices for detail on the assumptions we make and the impact of these on our estimate of mortgage prisoners):

- First, **34,000** mortgages (17% of mortgages in closed books with inactive firms) where borrowers cannot switch as they are not up to date with payments. We take these away because borrowers who are not up to date with payments cannot switch to a new deal even if they have a mortgage with a lender in the active market.
- Second, **18,000** mortgages (9%) which are near term (balance of less than £10,000 and/or have a short remaining mortgage term of 2 years or less). We remove these mortgages as well, because the borrowers of these mortgages are unlikely to be able to switch to a new deal in the active market. This is because borrowers need a minimum balance and term to be eligible for a new deal.
- Third, we estimate that the borrowers of **66,000** mortgages (34%) should be able to switch because they are likely to be within the credit risk appetite of active lenders. While some of these 66,000 may not save money by switching, for example because they pay a relatively low rate or have a small balance outstanding on a repayment mortgage, others who pay higher rates may benefit from switching to a cheaper deal.

- This leaves us with **77,000** mortgages (40%). We estimate the borrowers of these mortgages are unable to switch because we assume that:
  - those with interest-only mortgages with a loan to value (LTV) greater than 50% are unlikely to have a credible strategy to repay the loan amount borrowed and so will be unable to switch
  - those with a lower credit score than the least creditworthy recent switchers will be unable to switch
- Fourth, we estimate that the borrowers of 30,000 mortgages who are unable to switch would be unlikely to save money from switching even if they could switch. So they are not mortgage prisoners under our definition.

6.6 This gives an estimate of **47,000** mortgages whose borrowers meet our definition of a **mortgage prisoner**. This is because they are unable to switch and would be more likely to benefit from switching, if they could switch and if products were available at a lower rate than they currently pay.

Assessing if borrowers who cannot switch are likely to benefit from switching

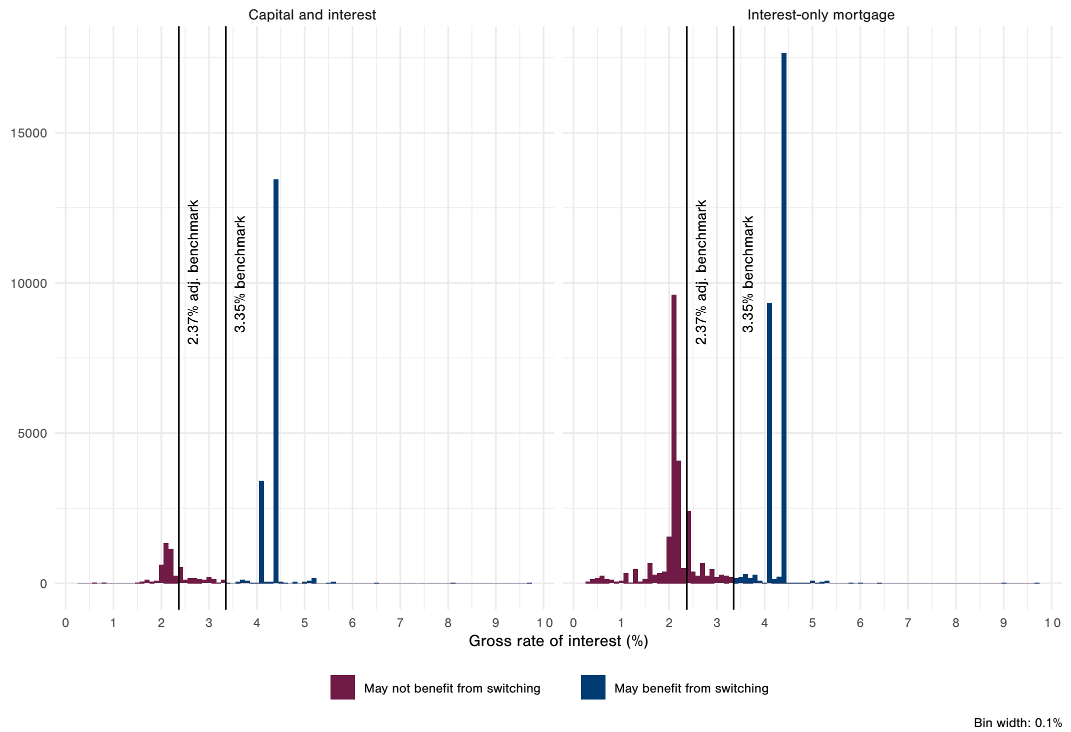
6.7 In order to work out whether borrowers would benefit from switching we would need to compare the rate they pay now with the rate they could otherwise get taking account of any fees to switch. We cannot do this for borrowers who cannot switch as there is no comparable rate. So we have to use an illustrative rate as a proxy to assess the likelihood that a borrower who cannot switch would benefit from switching, if they were able to switch.

6.8 We consider those who pay a rate which is lower than the illustrative rate as less likely to benefit from switching and we do not include them in our number of mortgage prisoners. Conversely, those who pay a rate that is higher than the illustrative rate would be more likely to benefit from switching, if they could switch, and so they are mortgage prisoners under our definition. We make this assessment so that we can provide detail on the characteristics of mortgage prisoners to help inform potential practical and proportionate solutions for them.

6.9 We have had to make a judgement on what to use as the illustrative rate. We could use a rate of 2.37% which is the equivalent average introductory rate for prime mortgages, according to Moneyfacts at the time of the analysis – this results in an estimate of 54,000 mortgage prisoners. We could use a rate of 3.6% which is the average introductory rate for non-prime mortgages according to Moneyfacts at the time of the analysis – this results in an estimate of 46,000 mortgage prisoners. We have chosen to use a rate of 3.35% which is the lowest standard variable rate at the time of our analysis and is the rate we used previously in the July 2020 Statement on Mortgage Prisoners. This sits in between the average introductory rates available to prime and non-prime borrowers and results in an estimate of 47,000 mortgage prisoners.

6.10 The illustrative rate we have used to estimate the number of mortgage prisoners is not intended as a judgement as to whether those paying a higher rate are paying more than they should, or whether they face harm as a result. Borrowers that we estimate cannot switch pay an average interest rate of 3.5% (and many pay around 2%) so the illustrative rate is a way of showing that not all of those unable to switch (77,000) would be likely to save money from switching. Many are paying relatively low rates given their loan and borrower characteristics and even if they could switch, they would not realistically be able to save money by switching to a lower rate, particularly once fees are accounted for.

Figure 2: Distribution of interest rate for the 77,000 borrowers unable to switch



6.11 Importantly, as Figure 2 shows, the number of mortgage prisoners is not particularly sensitive to the interest rate we use to establish who is more likely to benefit from switching. In each of the examples we used in paragraph 6.9, the estimate of the number of mortgage prisoners is around 50,000.

Characteristics of mortgage prisoners

6.12 The 47,000 mortgage prisoners pay 4.3% on average and typically pay rates between 4.1% and 4.4%.

6.13 The table below summarises the key characteristics. For more detail on these and other mortgage and borrower characteristics of mortgage prisoners see Annex 2.

Key characteristics of the 47,000 mortgage prisoners (medians)

	Capital and interest	Interest-only
LTV	51%	67%
Balance	£66,000	£127,000
Remaining term	15 yrs	10 yrs
Monthly repayment	£535	£472
Equity	£67,000	£59,000
Age	45	50
Unsecured debt	£12,000	£11,000

6.14 In Annex 2 we segment mortgage prisoners by various combined characteristics to help estimate the numbers of borrowers that are close to meeting the lending criteria (risk appetite) of active lenders. The segmentation estimates, though based on small samples, may inform actions that borrowers or others can take to become eligible to switch or to help develop new products for mortgage prisoners.

The effect of our regulatory interventions to date

6.15 We have reviewed the effects of our interventions to remove regulatory barriers to switching for mortgage borrowers who cannot otherwise switch. Our findings show this issue is complex.

Modified affordability assessment

6.16 We expected the flexibility provided by the modified affordability assessment to have enabled more borrowers to switch. Although removing regulatory barriers to switching helps, the primary barrier to these borrowers switching is the lack of lender risk appetite. There has also been only moderate engagement from borrowers.

6.17 At least 5 lenders currently provide switching options for mortgage prisoners using the modified affordability assessment or greater underwriting flexibility. Our Review found that the demand for and impact of these switching options has been limited. It found that:

- Lenders have had a limited appetite to offer these options.
- Of the small number of borrowers who applied to lenders the majority have borrower and loan characteristics that do not meet lenders' credit risk appetites.
- Our data indicates that around 200 borrowers have been directly helped to switch to a new deal as a result of these changes.
- Borrowers do not always engage with switching. For example, in response to 140,000 letters sent about potential switching options, the Money and Pensions Service (now known as MoneyHelper) received 534 calls and mortgage intermediaries received 702 calls. There will also have been some overlap between these calls.

6.18 However, over 2,000 borrowers (previously in the closed book inactive firm population) were able to switch to another lender without using the modified affordability assessment. Although we can't be certain (as we did not carry out any consumer research as part of the Review) some of them might have been prompted to switch by our requirement for inactive firms to contact customers about their options.

6.19 We have heard from some lenders that the pandemic had an impact on firms' plans, and meant they weren't able to offer switching options to mortgage prisoners. We have also heard that some may be considering making use of the flexibility in our rules and we encourage others to do the same.

Intra-group switching rule

6.20 A small number of financial groups have both an active lender and a closed book that is in a different entity to the lender. In October 2020 we extended the flexibility in our rules that allows lenders to choose not to undertake an affordability assessment if an existing borrower wanted to switch to a new deal and meets certain criteria (such as not borrowing more except to finance certain fees). This flexibility was extended to where a borrower currently has a mortgage in a closed book and wants to switch to a new deal with an active lender in the same financial group as their current provider. Our Review found that most, but not all, borrowers in this situation have, or will have, access to new deals.

7 Conclusions

7.1 Our Review sets out the different loan and borrower characteristics of the 195,000 mortgages in closed books with inactive firms. It includes our estimate of the number of mortgages whose borrowers can and cannot switch and of the number of mortgage prisoners. It considers the interest rates borrowers pay and how they compare to the interest rates available from active lenders to both prime and non-prime borrowers.

7.2 Some closed book borrowers pay lower interest rates and may not benefit from switching. Over half pay a rate of 3% or less and 95% of borrowers who have a mortgage in a closed book with an inactive firm are paying a lower rate than they did when they first took out the mortgage.

7.3 Not all borrowers who have mortgages in closed books with inactive firms are trapped. Our new further analysis has confirmed this. We estimate that there are 66,000 mortgages in closed books with inactive firms, just over a third, whose borrowers should be able to switch. Over 2,000 borrowers who had a mortgage in a closed book with an inactive lender have already switched to a new deal. Where borrowers have not yet tried to switch, consumer organisations or a mortgage intermediary may be able to help them assess whether they can save money, or otherwise benefit, by switching.

7.4 But we estimate there are 47,000 mortgage prisoners, a quarter of those who have mortgages with inactive firms, who cannot switch when it might benefit them to do so, because they have loan and/or borrower characteristics that are outside current lender appetite.

7.5 Our analysis and our engagement with consumer groups and consumer advocates suggests that some mortgage prisoners, like borrowers in the active market, have characteristics of vulnerability.

7.6 We are publishing data in our Review so lenders can consider whether they can adapt their lending criteria (or use the flexibility in our rules) to lend to closed book borrowers who are close to meeting their standard lending criteria at a lower rate or at a rate that enables them to fix their payments if they want to. We estimate that up to around 6,000 mortgages held by mortgage prisoners might be close to the risk appetite of lenders. We encourage lenders to consider if they can amend their lending criteria to lend to any of these mortgage prisoners, using the modified affordability assessment if appropriate.

7.7 Borrowers may be able to take steps, with the support of consumer organisations or a debt advice charity, to improve their chances of switching to a better deal in the longer term, by:

- Taking steps to improve their credit score or
- Paying down some of their interest-only mortgage to reduce the amount they need to borrow or
- Getting advice from a mortgage intermediary or debt advice charity to become ‘remortgage ready’. This includes exploring whether they may be able to convert some or all of their interest-only mortgage to a capital repayment mortgage

7.8 It is the borrower's responsibility to repay their mortgage at maturity. However, firms should work with interest-only customers to identify options and solutions that might help improve outcomes for them before the end of their mortgage term. Our guidance on dealing fairly with interest-only mortgage customers who risk being unable to repay their loan sets out what we expect firms to do to minimise the risk of non-repayment through early and effective consumer engagement over the mortgage term.

7.9 Our analysis found very few borrowers who are in negative equity. If the burden of a mortgage is difficult, debt advice charities can support mortgage prisoners to consider their alternative options including any very difficult decisions such as downsizing.

8 Next steps

8.1 This Review sets out the results of our analysis on the characteristics of borrowers who have mortgages in closed books with inactive firms, the number and characteristics of mortgage prisoners, and the effect of our regulatory interventions to enable switching. Our evidence points to solutions for mortgage prisoners that either encourage lenders to see if they can help those who are close to their criteria or that help borrowers improve their chances of switching. We welcome practical and proportionate initiatives from industry or others to provide these borrowers with tools or materials to help them do this.

8.2 Government and industry will use this Review to consider if there are further practical and proportionate solutions that will enable these borrowers to switch their mortgage where they would benefit from doing so. We will continue to support Government and industry with this.

8.3 Aligned with our proposals for a new Consumer Duty, we want to see a mortgage market that provides good outcomes for all borrowers – to enable choice and competition, the provision of fair value products and services and where customers in financial difficulty are treated fairly. We will continue to focus on those areas in the market where we identify the greatest harm which could affect mortgage prisoners and other borrowers. In particular:

- We will continue to monitor firms to make sure they provide all borrowers – in both closed and active books – with the support they need when they get into financial difficulty.
- Taking action as necessary to address harms we find.
- Carrying out work to understand the issues facing borrowers who have interest-only, or part repayment mortgages, and who do not have a credible strategy to repay the capital borrowed at the end of the mortgage term. This includes looking at strategies borrowers have to repay the amount borrowed on an interest-only basis, and actions firms are taking to help them consider their options, bearing in mind that borrowers are ultimately responsible for paying their mortgage debt.
- Supervising and enforcing our Guidance for firms on the fair treatment of vulnerable customers to help ensure fair outcomes for customers with characteristics of vulnerability.

Annex 1
Summary of the characteristics of the population of closed book mortgages with inactive firms

Contents of this annex

Section A. Explanation of data used and scope of analysis

Purpose of this analysis

1. This annex reports on our analysis of the population of first charge mortgages in closed books with inactive firms.

2. **For the purpose of this analysis, we are considering a closed book to be where a mortgage book is closed to new customers, usually held by an inactive firm, and the customer is unable to switch to a new mortgage product with that entity. An inactive firm is either a lender that no longer lends to new customers (an inactive lender) or they are not a lender and may not be regulated by the FCA.**

3. This analysis provides the context for our analysis on mortgage prisoners (in Annex 2) as mortgage prisoners are very likely to have a mortgage in a closed book with an inactive firm. We have carried out this analysis to help understand the characteristics of closed book mortgages and the borrowers who have them, and to compare them with the much larger population of mortgages that are not in closed books (i.e. most of the mortgages held by active lenders). We also wanted to set out the size of different segments of mortgages with particular characteristics within the closed book population.

4. The analysis in this annex is factual, based on the mortgage data that firms are required to report to us. It does not include economic modelling or assumptions (other than to estimate current loan-to-values) and does not attempt to consider other factors not visible in our data, for example the current credit status of borrowers.

Scope of analysis

5. This analysis focuses on first charge regulated mortgage contracts, reported by firms in the regulatory return (Product Sales Data: Mortgage Performance Data ('PSD007') as at June 2021, as being in a closed book with an inactive firm. The 'closed book' flag was introduced to PSD007 in the reporting period H1 2021, so this information is not available in previous reporting periods and has not been used in previously published analysis.

6. We want to focus on those borrowers who do not have switching options. We have therefore removed from the dataset mortgages reported as being in a closed book but where we know the borrower has access to internal product switches (for example, through intra-group switching). We also removed second charge mortgages, and lifetime mortgages (where we have been able to identify them), because they are not included in the scope of this analysis due to the different way these products operate.

7. The population of closed book mortgages included in this analysis is just under 195,000. This represents 2.3% of the total population of 8.5 million first charge regulated mortgage contracts (excluding lifetime mortgages).

8. Throughout this analysis, we use the term 'closed book' mortgages as shorthand to refer to this population of 195,000 mortgages. We use the term 'active book' mortgages to refer to all other first charge regulated mortgages reported in PSD007 (excluding lifetime mortgages).

9. The population of 195,000 closed book mortgages is lower than the closed book population figure of 250,000 used in the Statement on mortgage prisoners published in 2020. This is due to two main reasons:

- We use a different methodology. The current population is based on reporting from firms using the 'closed book' flag introduced into PSD007 in H1 2021. Whereas the 2020 figure was based on a combination of a one-off data request to third party administrators (2019 data), supplemented by PSD007 data that did not have the closed book flag.
- This analysis is more up-to-date. There will have been redemptions and other changes that have occurred since the 2020 analysis, which was based on data from 2019. Since then some borrowers will have remortgaged, moved, repaid etc. For example, our analysis shows that almost 20,500 closed book accounts were closed in H1 2021, including over 2,000 that remortgaged to other lenders.

10. Further technical details of the data and methodology used in this analysis are set out in the technical note in Section G of this annex.

11. In this annex, most data is set out in percentage terms, for example the charts show the proportions of closed or active book mortgages that have particular characteristics. We are publishing a separate document on the FCA website that sets out the number of mortgages in each category for the charts published in Section C (current characteristics of closed book mortgages) and Section D (characteristics at origination).

12. We are also publishing a separate document that sets out the segmentation analysis referred to in Section E of this annex.

Section B. Summary of key findings

13. The population of closed book mortgages included in this analysis is just under 195,000. This represents 2.3% of the total population of 8.5 million first charge regulated mortgage contracts (excluding lifetime mortgages).

14. Our analysis found that:

- 97% of the closed book mortgages considered in this analysis were originated in the pre-financial crisis period up to and including 2008, before lender risk appetites and regulatory expectations tightened after the financial crisis. This compares to 19% of active book mortgages.
- 94% of the closed book mortgages are currently on variable rates. This includes 36% on a standard variable rate (SVR), 30% on a base rate tracker, and 27% on a LIBOR tracker.
- 50% of closed book mortgages are paying an interest rate of 3% or less. 47% pay an interest rate of between 3% and 5%. 3.3% of closed book mortgages pay interest rates of more than 5%.
- 95% of closed book mortgages are paying a lower interest rate than at origination, reflecting the fall in interest rates since 2008. 51% are paying a rate of at least 2.5 percentage points less than at origination.
- Closed book mortgages are more likely to currently display higher risk characteristics than active book mortgages. For example, 17% have a current mortgage payment shortfall (compared to 2% in active books), and 53% are interest-only (compared to 9% in active books).
- Closed book mortgages also tended to have certain higher risk characteristics than active book mortgages at origination. For example, 46% did not have their income evidenced, compared with 11% of active book mortgages; and 20% of closed book mortgage borrowers had impaired credit, compared with under 1% of active book mortgages.
- There isn't a strong correlation between the interest rate paid and the incidence of payment shortfalls, when looking at the distribution of closed book mortgages with a current payment shortfall. So, those borrowers in closed books who pay higher interest rates are not more likely to be in payment difficulty than those on lower interest rates.

15. However, closed book mortgages are not a homogenous group, and have a wide range of characteristics. We set out more details of the different 'segments' within the closed book mortgage population, and the size of those segments (see section E of this annex). This aims to help stakeholders think about potential options for different cohorts of borrowers. This segmentation analysis is based solely on our regulatory data (as explained in Section A above), without matching with any other datasets. There will be other factors that we cannot see directly in our regulatory data, such as the current financial status and credit score of the borrowers, which may affect their ability to remortgage. This is why the numbers in this annex differ from the analysis of mortgage prisoners set out in Annex 2, which is matched with other data sources.

16. We also identified 2,201 closed book mortgages that have remortgaged to another lender in the period H1 2021, mostly without use of the 'modified affordability assessment'. This shows that some borrowers with closed book mortgages have been able to switch lenders using normal channels. Further details are set out in section F of this annex.

Section C. Current characteristics of closed book mortgages

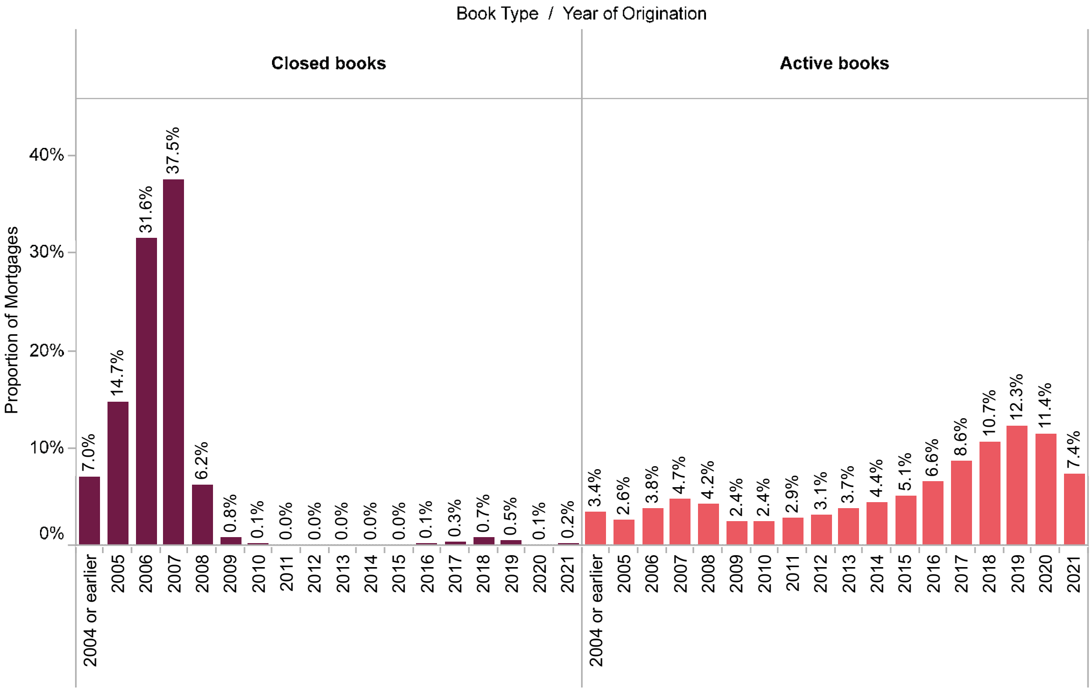
17. **This analysis is based on mortgage data covering the period H1 2021, and reflects the position of these mortgages at the end of that period i.e. 30 June 2021, extracted from our live data systems in the seven days commencing 23 October 2021 (unless otherwise stated).**

Year of origination

18. The vast majority (97%) of closed book mortgages were originated (i.e. taken out by the borrower) in 2008 or before. Whereas only 18.7% of active book mortgages were originated in 2008 or before.

19. This was in the pre-financial crisis period before lender risk appetites and regulatory expectations tightened.

Figure 1. Year of origination, closed books and active books.



Mortgages in payment difficulty

20. We can measure mortgage payment difficulties in various ways. In this analysis we use two measures, 'mortgage payment shortfall' and 'mortgage arrears'. They are explained as follows:

- Mortgage payment shortfall: This is where a mortgage customer is behind on their payments by any amount. So it includes mortgages that might be behind by a small amount, as well as those that might be behind by larger amounts.

- Mortgage arrears: This is where a mortgage customer has a shortfall equivalent to two or more regular payments. So it is limited to payment difficulties that are potentially more significant.

21. So mortgages with mortgage arrears are a sub-set of mortgages with a payment shortfall.

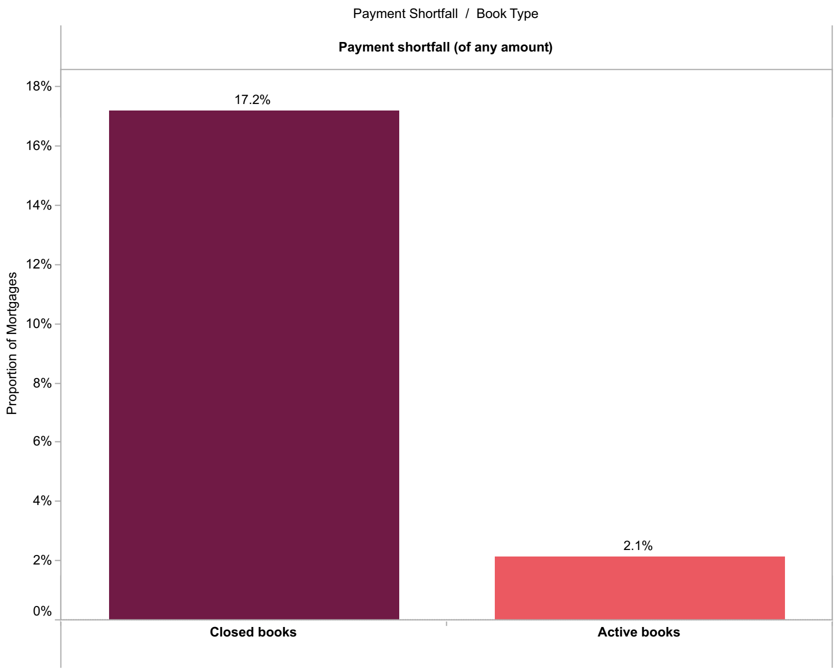
22. In this annex, payment shortfalls and mortgage arrears are measured as of 30 June 2021.

Mortgage payment shortfall (of any amount)

23. Closed books have a significantly higher proportion of mortgages in payment shortfall (17.2%) compared with active books (2.1%).

24. Conversely, 82.8% of closed book mortgages are currently up to date with payments.

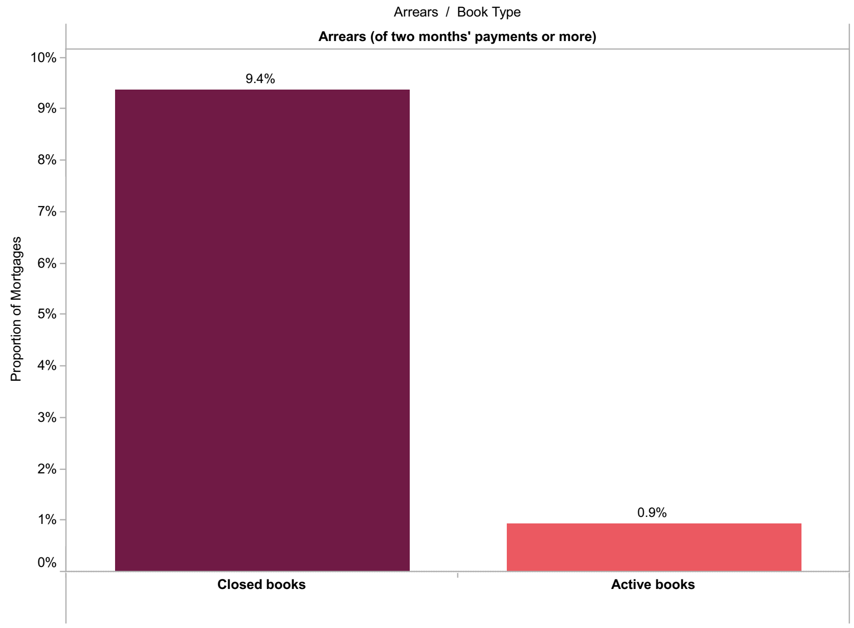
Figure 2. Proportion of mortgages with a current payment shortfall (any amount), closed books and active books



Mortgages in arrears (shortfall of two months' payments or more)

25. Closed books have a significantly higher proportion of mortgages in arrears (9.4%) compared with active books (0.9%).

Figure 3. Proportion of mortgages with current arrears (shortfall of two months' payments or more), closed books and active books



Current interest rate

Level of current interest rate

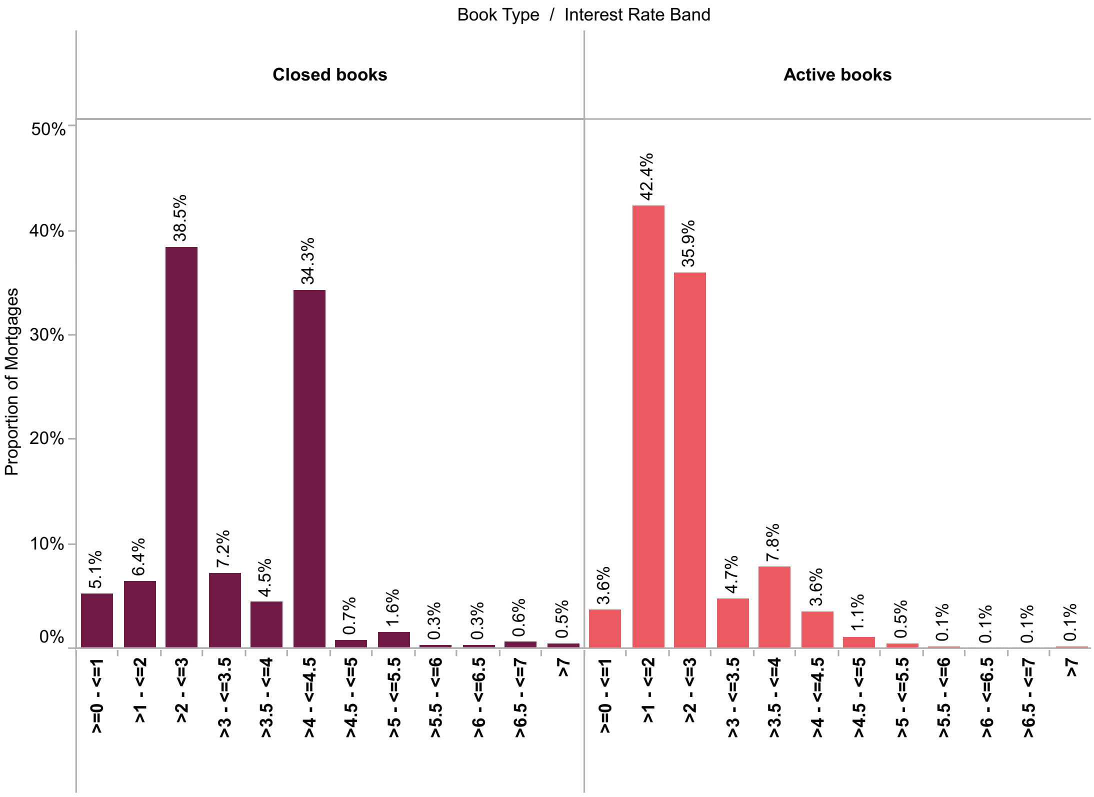
26. Most (over 85%) of closed book mortgages pay interest rates of between 2% and 5%.

27. 50% of closed book mortgages have an interest rate of 3% or less, compared to 82% of active books.

28. 46.7% of closed book mortgages have an interest rate of 3% to 5%, compared to 17.2% of active books

29. 3.3% of closed book mortgages pay interest rates of more than 5%, with 0.5% paying over 7%.

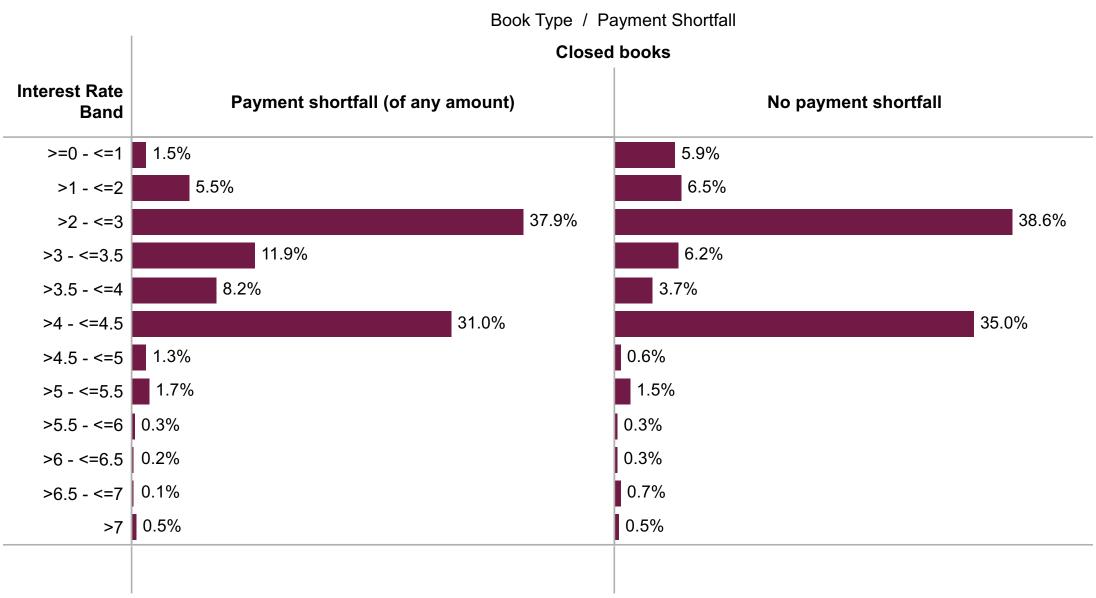
Figure 4. Proportion of mortgages by current interest rate, closed books and active books



Comparison of interest rates between closed book mortgages with and without a current payment shortfall (of any amount)

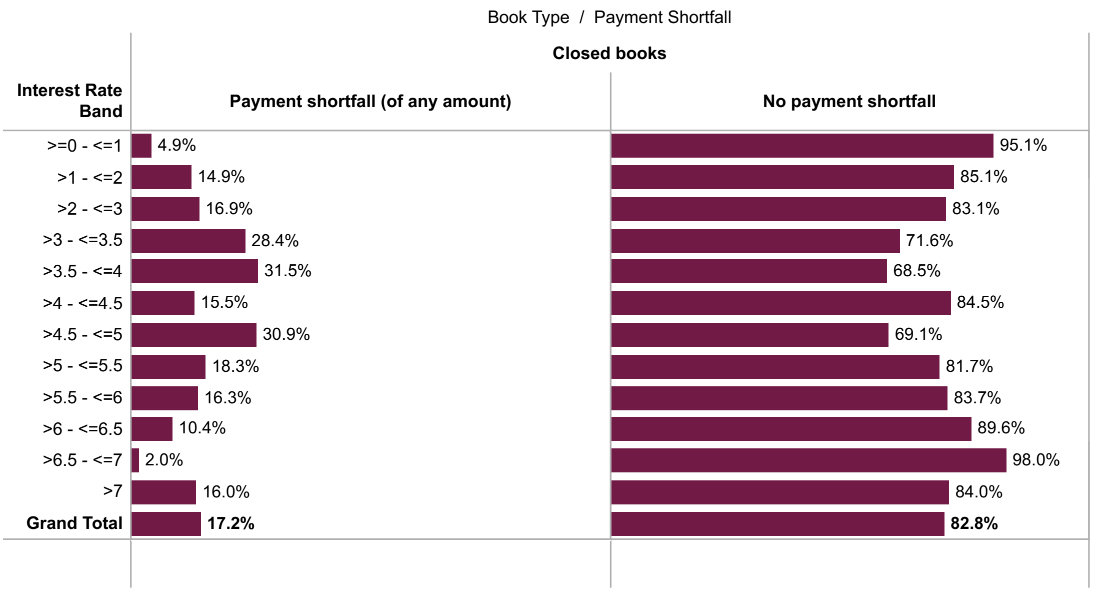
30. There isn't a strong correlation between the interest rate paid and the incidence of payment shortfalls in closed book mortgages, when comparing the distribution of mortgages with and without a payment shortfall for each interest rate band, as shown in figure 5.

Figure 5. Closed book mortgages by current interest rate – distribution across interest rate bands of mortgages with and without a current payment shortfall (of any amount)



31. The proportion of closed book mortgages in payment shortfall is 17.2%. Figure 6 shows that there is a higher proportion of payment shortfalls than average in the interest rate bands between 3% and 4%, and 4.5% to 5%. But there is a lower proportion in other bands, including 4% to 4.5%.

Figure 6. Closed book mortgages by interest rate – proportion of mortgages with and without a current payment shortfall (of any amount) in each interest rate band



32. When looking at the median interest rates for mortgages with and without a payment shortfall, there is less of a differential for closed book mortgages compared with active mortgages.

33. The median interest rate for a closed book mortgage with a payment shortfall is 3.2%, compared with 2.9% without a payment shortfall.

34. The median interest rate for an active book mortgage with a payment shortfall is 2.9%, compared with 2.1% without a payment shortfall.

Figure 7. Median interest rates, closed books and active books, for mortgages with and without a current payment shortfall (of any amount)

Book Type	Payment shortfall (of any amount)	No payment shortfall	Grand Total
Closed books	3.2	2.9	3.0
Active books	2.9	2.1	2.1
Grand Total	**3.0**	**2.1**	**2.1**

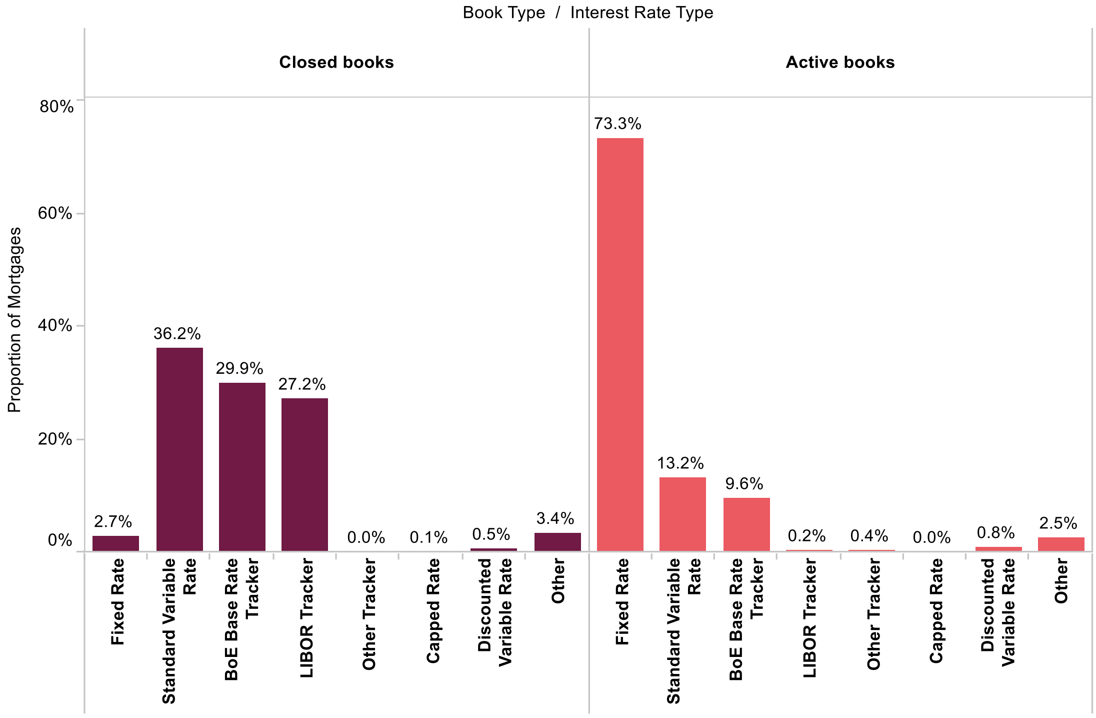
Type of interest rate

35. 93.8% of closed books are on a variable rate of some sort, including:

- 36.2% on a standard variable rate (SVR)
- 29.9% on a base rate tracker
- 27.2% on a LIBOR tracker

36. This compares with active books where the majority (73.3%) are on fixed rates.

Figure 8. Proportion of mortgages on different interest rate types, closed books and active books



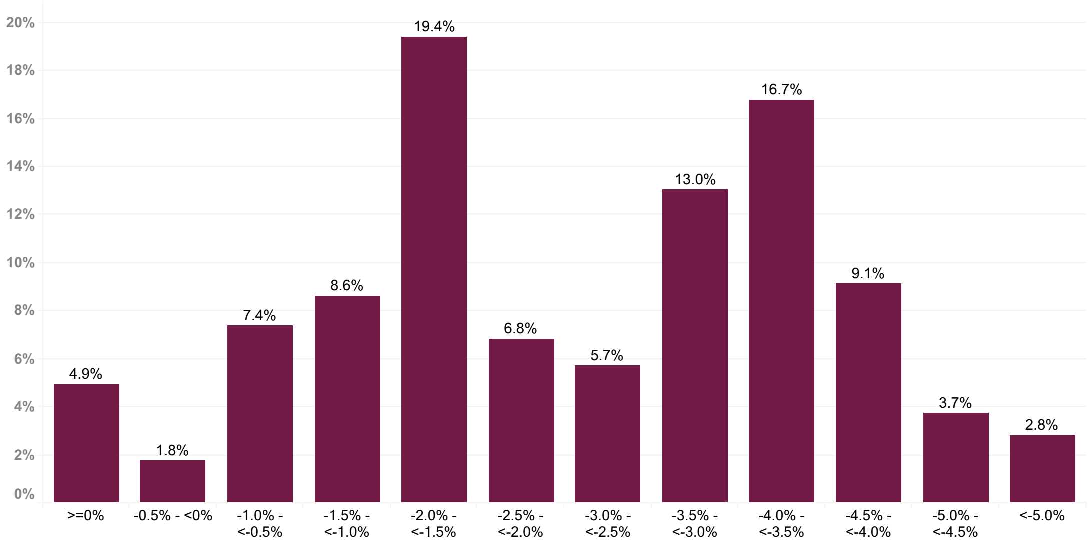
Current interest rate compared with interest rate at origination in closed book mortgages

37. Over 95% of closed book mortgages have a lower interest rate (as of 30 June 2021) than at origination.

- 77.3% are paying an interest rate of at least 1.5 percentage points less
- 51.1% are paying an interest rate of at least 2.5 percentage points less
- 32.4% are paying an interest rate of at least 3.5 percentage points less

38. As a result, these mortgages now have lower mortgage payments than at the outset. This reflects the significant fall in the Bank of England Base Rate that happened after most of the closed book mortgages were taken out. For example, Bank of England Base Rate was 5.75% in 2007, compared with 0.1% in H1 2021.

Figure 9. Difference between current and initial interest rate, by proportion of closed book mortgages



Note: in figure 9 a positive value (left-hand column) represents cases where the current rate is higher than the initial rate. Negative values (remaining columns) represent cases where the current rate is lower than the initial rate.

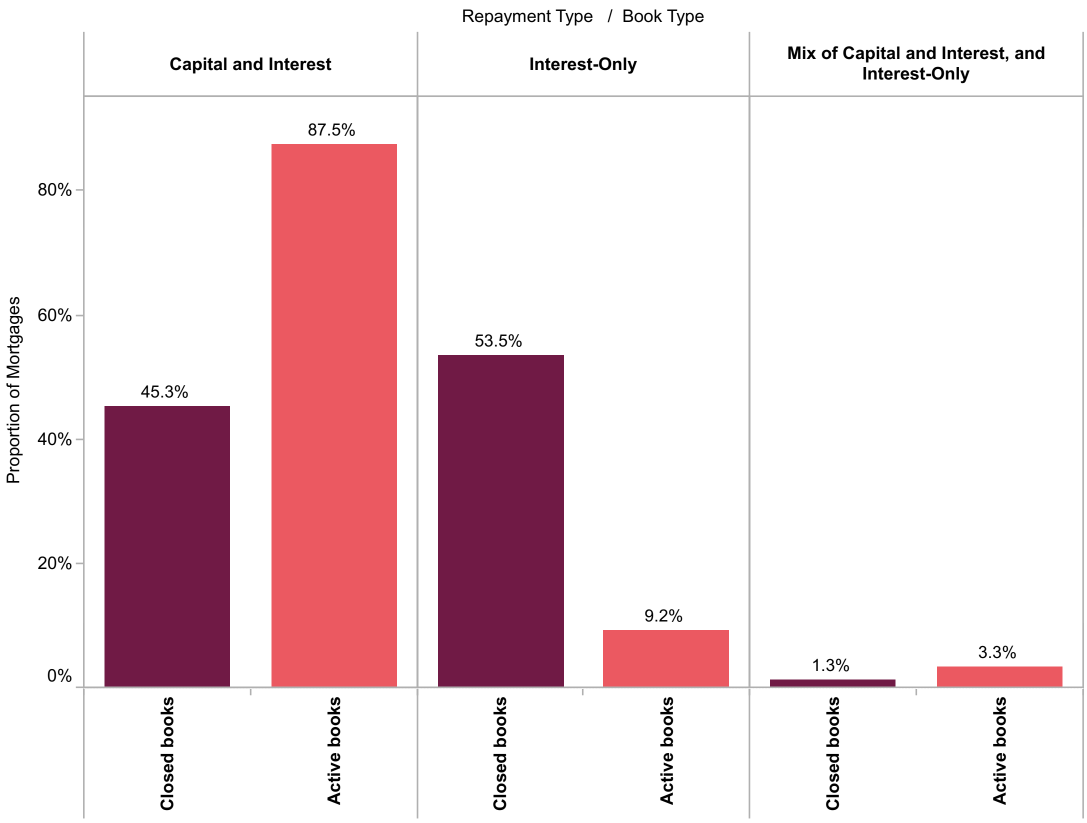
Repayment type

39. Closed book mortgages have a significantly higher proportion of interest-only than active book mortgages (53.5% compared with 9.2%).

40. A small proportion of mortgages are on a part capital and interest and part interest-only (1.3% of closed books and 3.3% of active books).

41. 45.3% of closed book mortgages have a capital and interest mortgage, compared with 87.5% of active book mortgages.

Figure 10. Proportion of mortgages by repayment type, closed books and active books

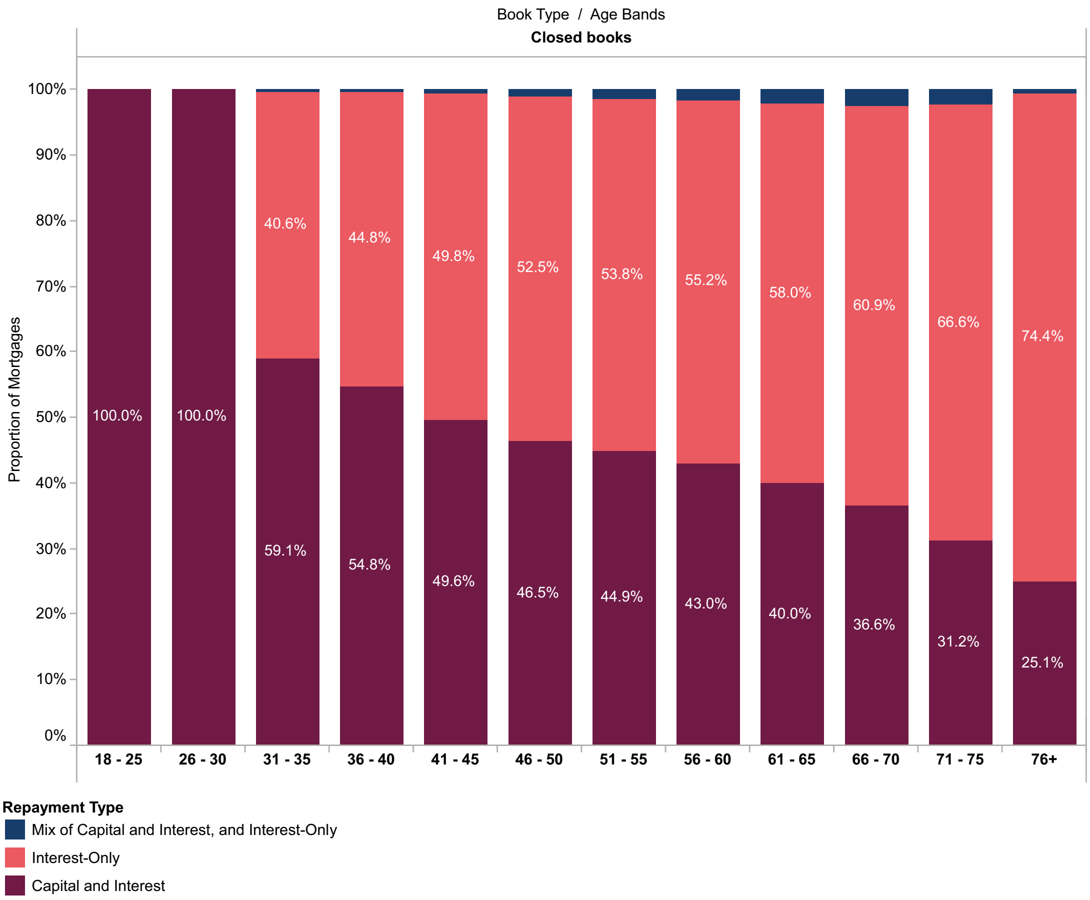


Repayment type in combination with other factors in closed books

Repayment type and age of main borrower

42. The proportion of interest-only closed book mortgages increases through the age bands. For example, 52.5% of closed book mortgages are interest-only where the main borrower (i.e. first borrower) is in the 46-50 age band, but this increases to 60.9% in the 66-70 age band.

Figure 11. Proportion of closed book mortgages by repayment type by age of main borrower

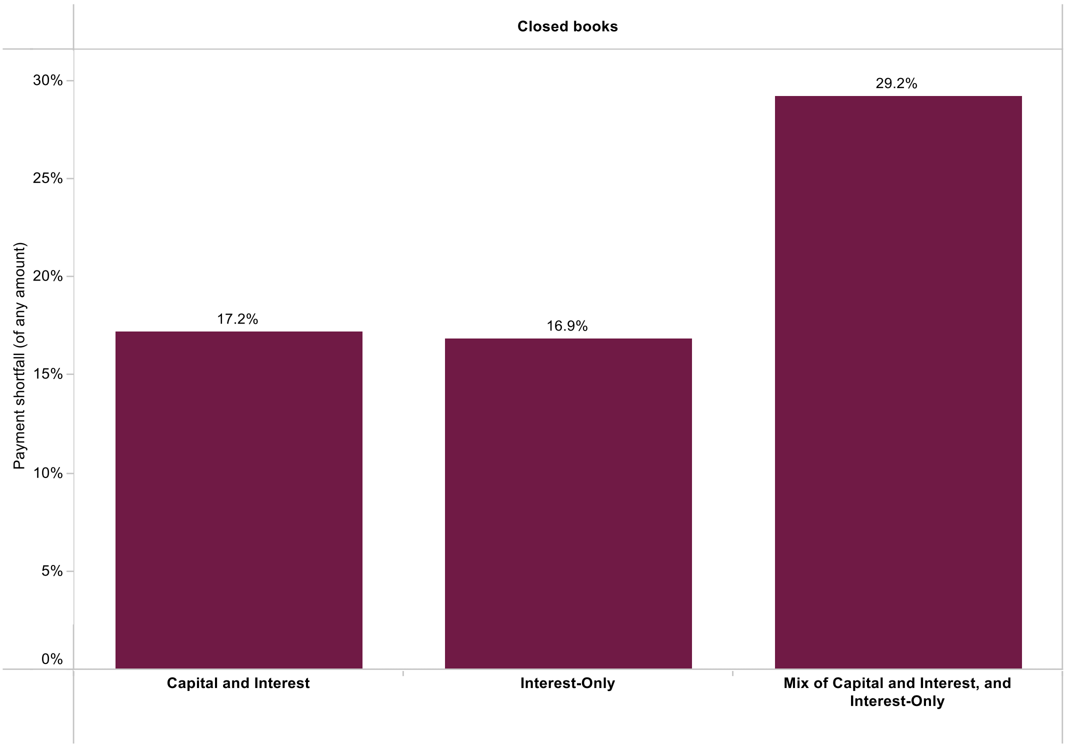


Repayment method and current mortgage payment shortfall (of any amount)

43. The incidence of current payment shortfall is similar between capital and interest (17.2%) and interest-only (16.9%) mortgages.

44. It is somewhat higher for part capital and interest and part interest-only mortgages (29.2%). It is not obvious what is driving this, but this represents quite a small number of mortgages (718 mortgages in total).

Figure 12. Proportion of closed book mortgages by repayment type and current payment shortfall (of any amount)

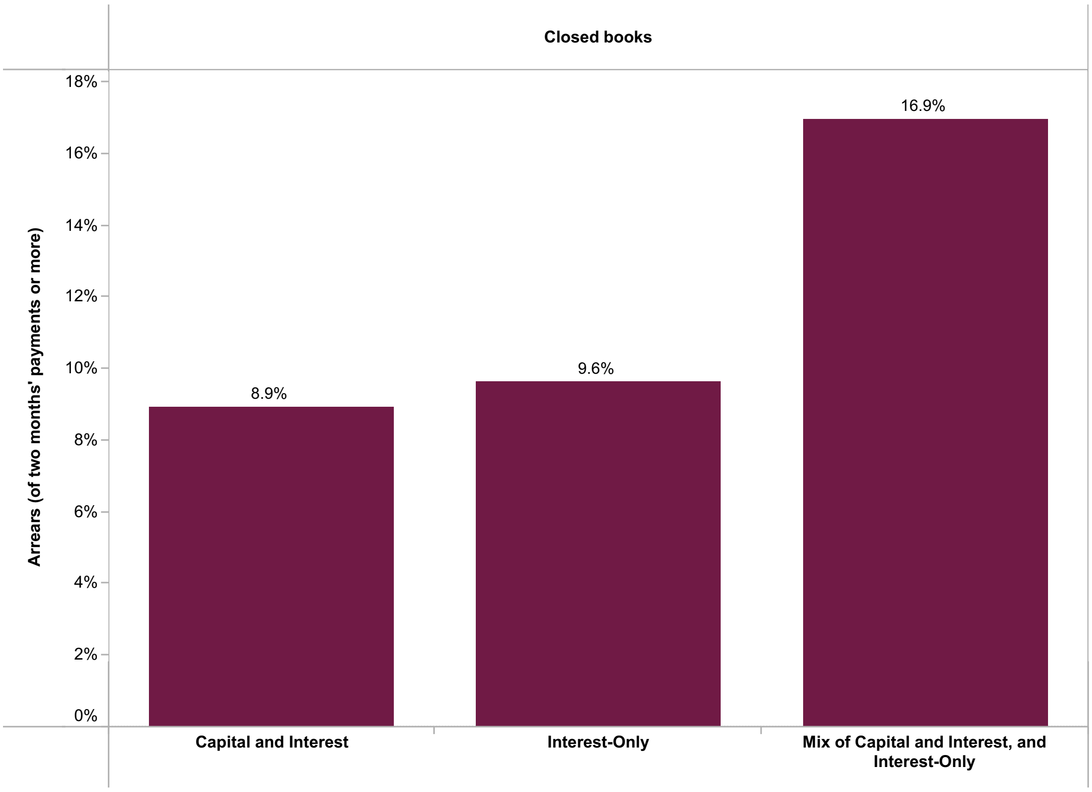


Repayment method and current mortgage arrears (shortfall of two months' payments or more)

45. The incidence of arrears follows a similar pattern. It is broadly the same between capital and interest (8.9%) and interest-only (9.6%) mortgages.

46. It is somewhat higher for part and part mortgages (16.9%). Again, it is not obvious what is driving this, but this represents a small number of mortgages (415 mortgages in total).

Figure 13. Proportion of closed book mortgages by repayment type and current mortgage arrears (shortfall of two months' payments or more)

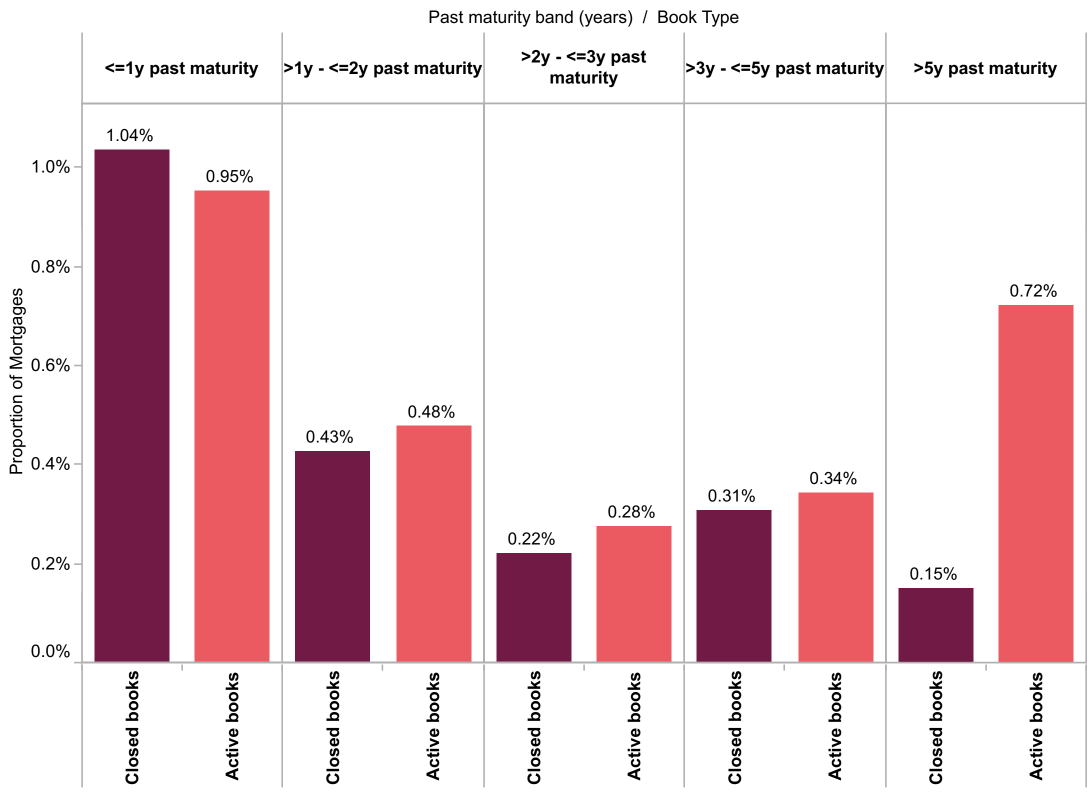


Interest-only mortgages that are past maturity

47. Closed books have a slightly lower proportion of interest-only mortgages that are reported as being past maturity compared to active book mortgages (2.14% compared with 2.77%).

48. Of those mortgages that are past maturity, the closed book mortgages tend to have matured more recently than past-maturity mortgages in active books.

Figure 14. Proportion of interest-only mortgages past maturity, by time past maturity, closed books and active books



Current payment difficulties in past-maturity mortgages

49. When looking within the population of past-maturity mortgages, closed book mortgages have a higher proportion with payment difficulties than active mortgages.

50. 26.5% of closed book mortgages past maturity have a current payment shortfall compared with 13.4% of active book mortgages. However, the absolute numbers are small e.g. there are 590 closed book mortgages past maturity that have a payment shortfall.

51. 22.8% of closed book mortgages past maturity are two months' or more in arrears (compared with 10.3% of active book mortgages), but again this represents a relatively small number of closed book mortgages (509 mortgages). (Note that this is a subset of the mortgages with a payment shortfall, rather than an additional number).

Figure 15. Proportion of interest-only mortgages past maturity with a current payment shortfall (of any amount), by time past maturity, closed books and active books

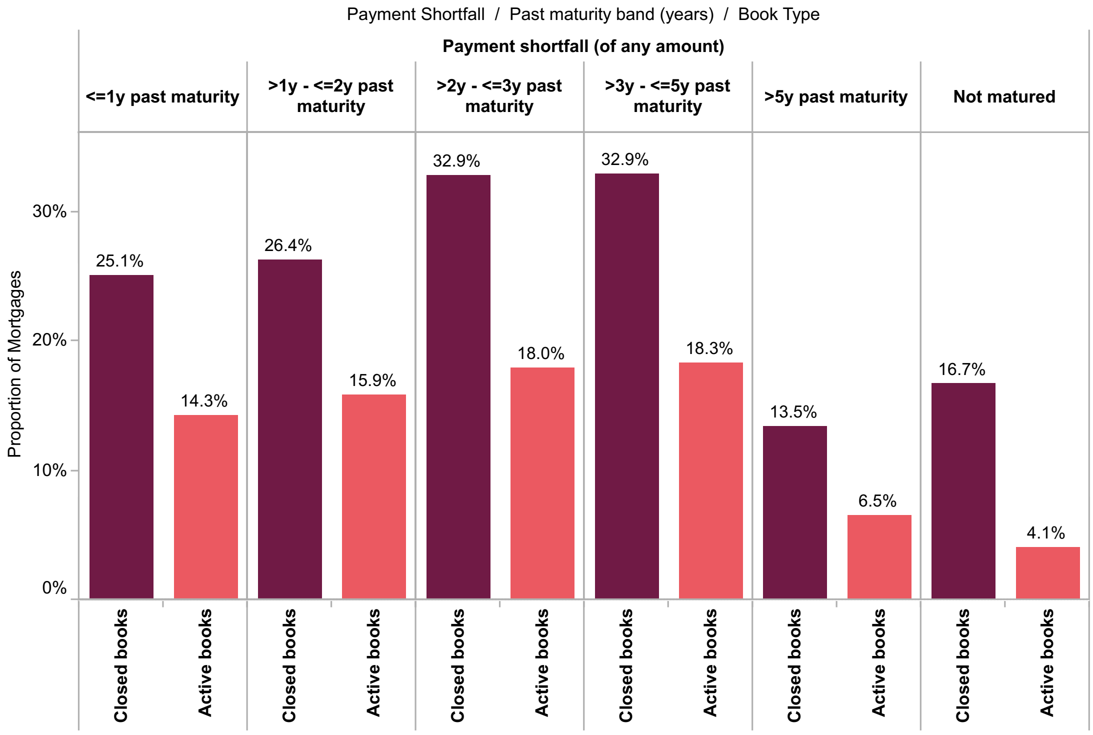
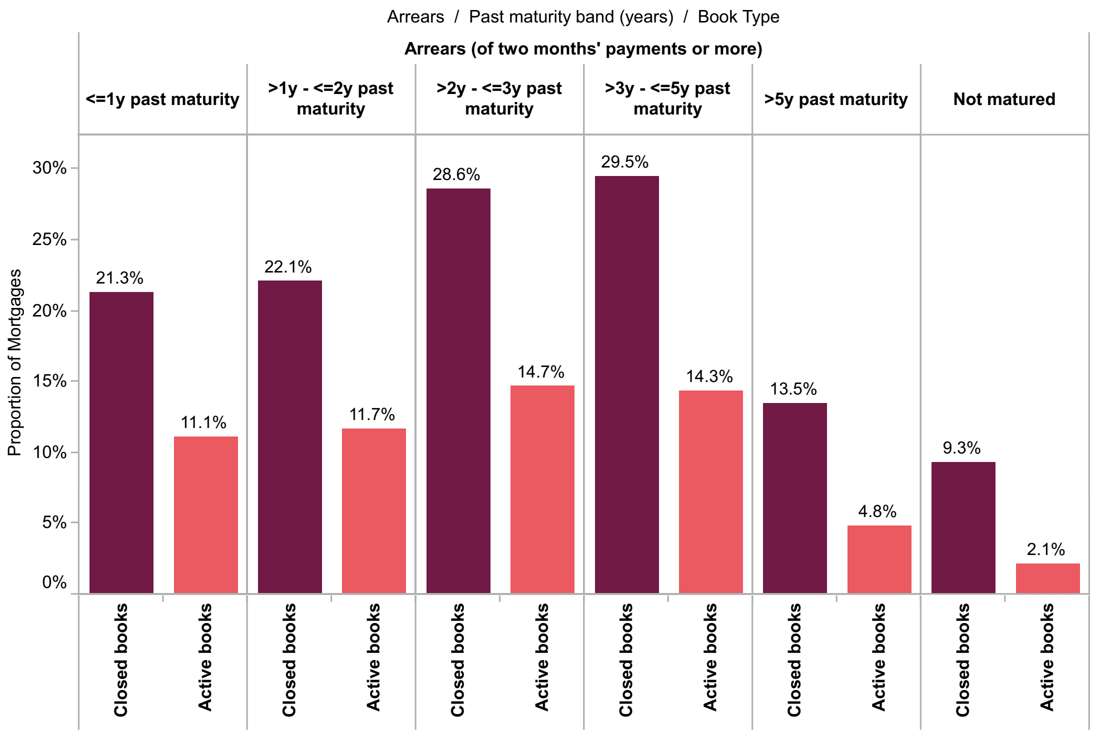


Figure 16. Proportion of interest-only mortgages past maturity with current mortgage arrears (shortfall of two months' payments or more), by time past maturity, closed books and active books



Current age of main borrower

52. Borrowers in closed books have an older age profile compared with active books. This becomes more pronounced in the older age brackets. So, for example, when looking at age of main borrower (i.e. first borrower), the 46-50 bracket represents 18.5% of closed book mortgages, compared to 15.5% of active books. But the 76+ age bracket represents 2.1% of closed book mortgages compared to 0.6% of active books.

53. 35.3% of closed book mortgages have a main borrower who is 56 or over, compared to 17.8% of active books.

Figure 17. Proportion of mortgages by age of main borrower, closed books and active books

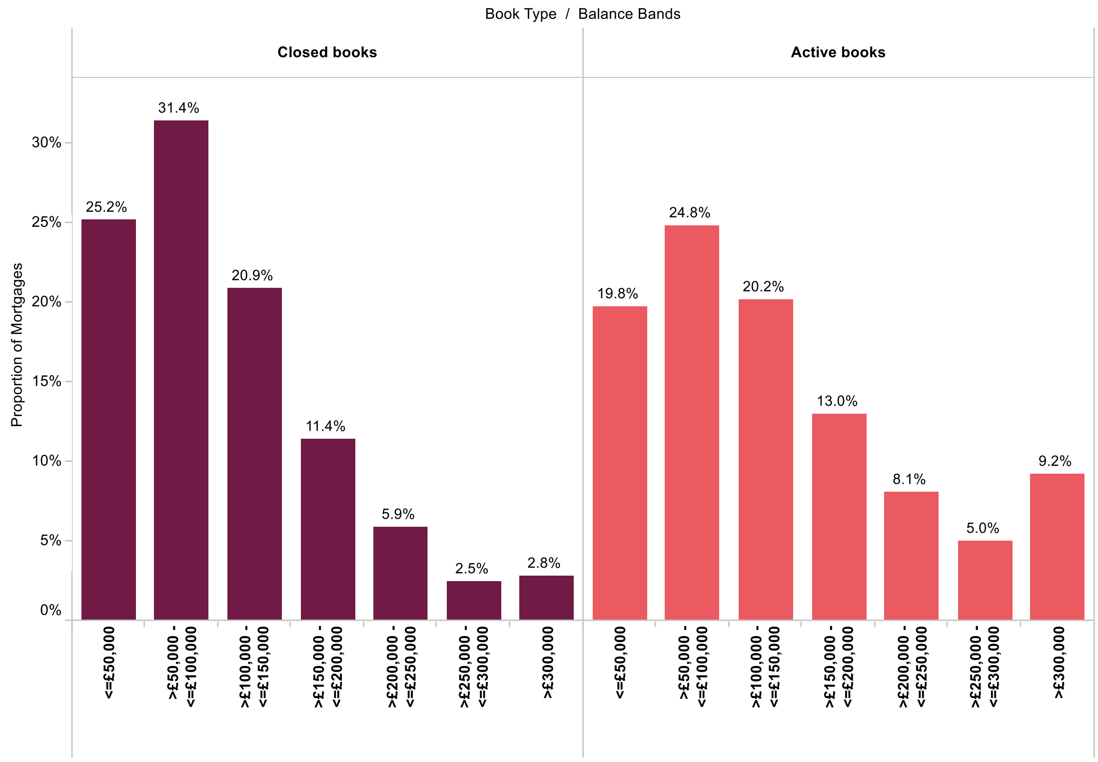
Current outstanding balance

54. Closed book mortgages tend to have slightly lower balances than those in active books. This is unsurprising given that most were originated a relatively long time ago (i.e. in 2008 or before). For example:

- 77.5% of closed book mortgages have a balance of £150,000 or less, compared with 64.8% of active books.
- 56.6% of closed book mortgages have a balance of £100,000 or less, compared with 44.6% of active book mortgages.
- 25.2% of closed books have balances of £50,000 or less compared with 19.8% of active books.

55. At the other end of the scale, 11.2% of closed book mortgages have a balance over £200,000, compared with 22.3% of active books.

Figure 18. Proportion of mortgages by current outstanding balance, closed books and active books



Current remaining term

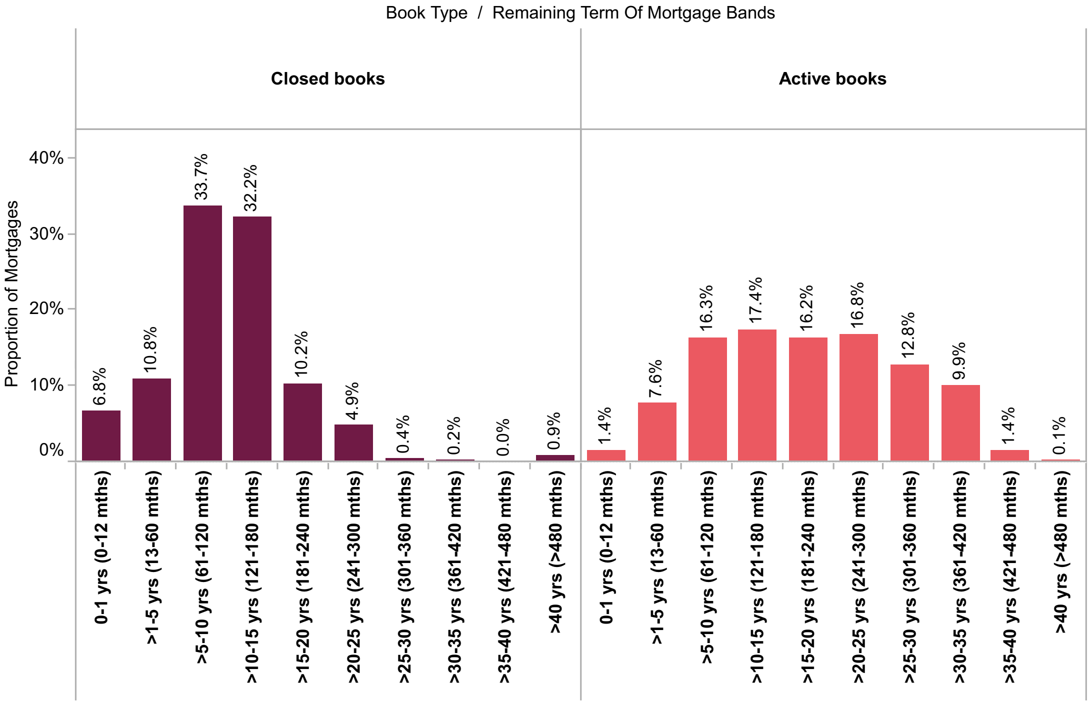
56. Closed book mortgages tend to have shorter remaining terms than mortgages in active books again reflecting the overall age of closed book loans. For example:

- 17.6% of closed book mortgages have five years or less to run, compared with 9% of active book mortgages.
- 51.3% of closed book mortgages have 10 years or less to run, compared with 25.3% of active book mortgages.

57. But a sizeable proportion of closed book mortgages still have a material period of time to run. For example:

- 48.8% of closed book mortgages have a remaining term of over 10 years.
- 16.6% of closed book mortgages have a remaining term of over 15 years.
- 6.4% of closed book mortgages have a remaining term over 20 years.

Figure 19. Proportion of mortgages by current remaining term, closed books and active books



Loan-to-value (LTV)

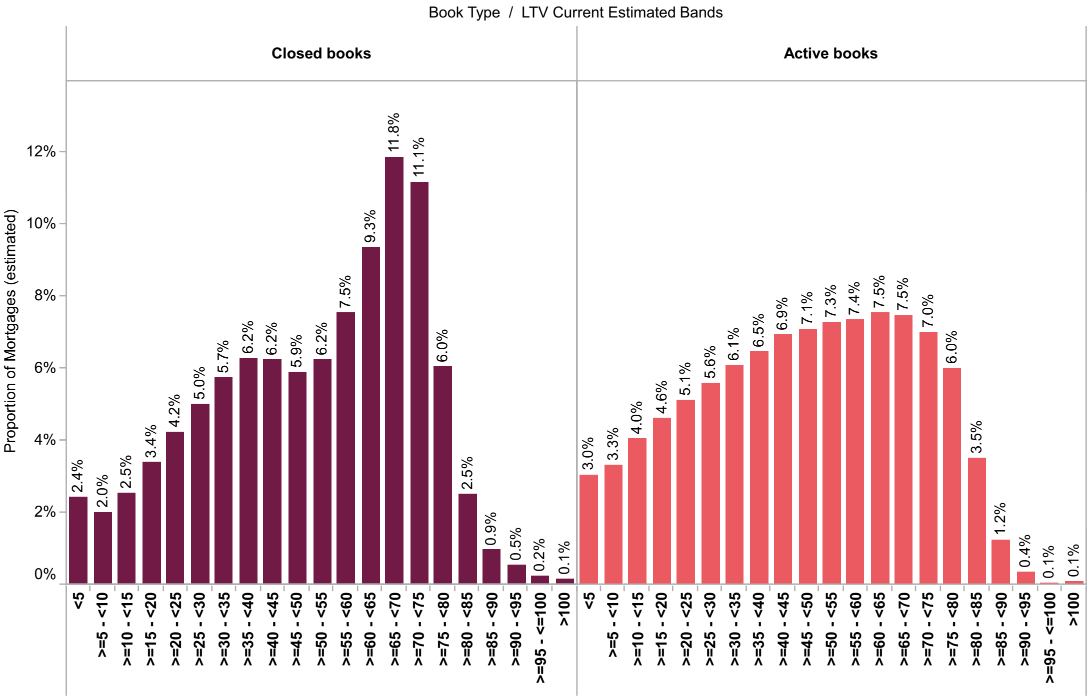
Note: The LTV figures in this annex are estimates. This is for two reasons. Firstly, we have to estimate how the value of the property has changed since the outset of the mortgage, when the original value was reported to us in the sale record in PSD001. Secondly, we cannot match all current mortgage records in PSD007 with their sale record in PSD001. As a result, we can only match 74% of closed book mortgages and 87% of active book mortgages with their sale record. We explain this in more detail in the technical note in Section G of this annex.

58. When comparing LTVs in closed book and active book mortgages, we can see the following:

- 43.6% of closed book mortgages have an LTV of less than 50%, compared to 52.2% of active books
- 89.7% of closed book mortgages have an LTV less than 75%, compared to 88.7% of active books.
- When compared with active book mortgages, there are a higher proportion of closed book mortgages in the 60%-75% LTV band, and above 90% LTV, but less in the lower LTV bands (up to 55% LTV) and the 80%-90% LTV band.

59. Looking at higher LTVs, 0.37% of closed book mortgages have an LTV of 95% or more, and 0.15% (288 mortgages) have an estimated LTV of 100% or more. Therefore, negative equity does not appear to be a widespread issue in closed book mortgages.

Figure 20. Proportion of mortgages by LTV band, closed books and active books



LTV in combination with other factors in closed book mortgages

60. When we look at estimated LTV combined with other factors (such as current payment difficulties, and repayment method), some distinct patterns emerge.

LTV and current mortgage payment difficulties

61. Closed book mortgages at higher LTVs are more likely to have current payment shortfalls and mortgage arrears than at lower LTVs.

62. 17.2% of closed book mortgages have payment shortfalls (of any amount), and 9.4% have mortgage arrears (of two months payments or more). But for both this becomes noticeably more pronounced above 75% LTV. Although there are a relatively small number of accounts in the highest LTV bands.

Figure 21. Proportion of mortgages in closed books with a current payment shortfall (of any amount), by LTV band

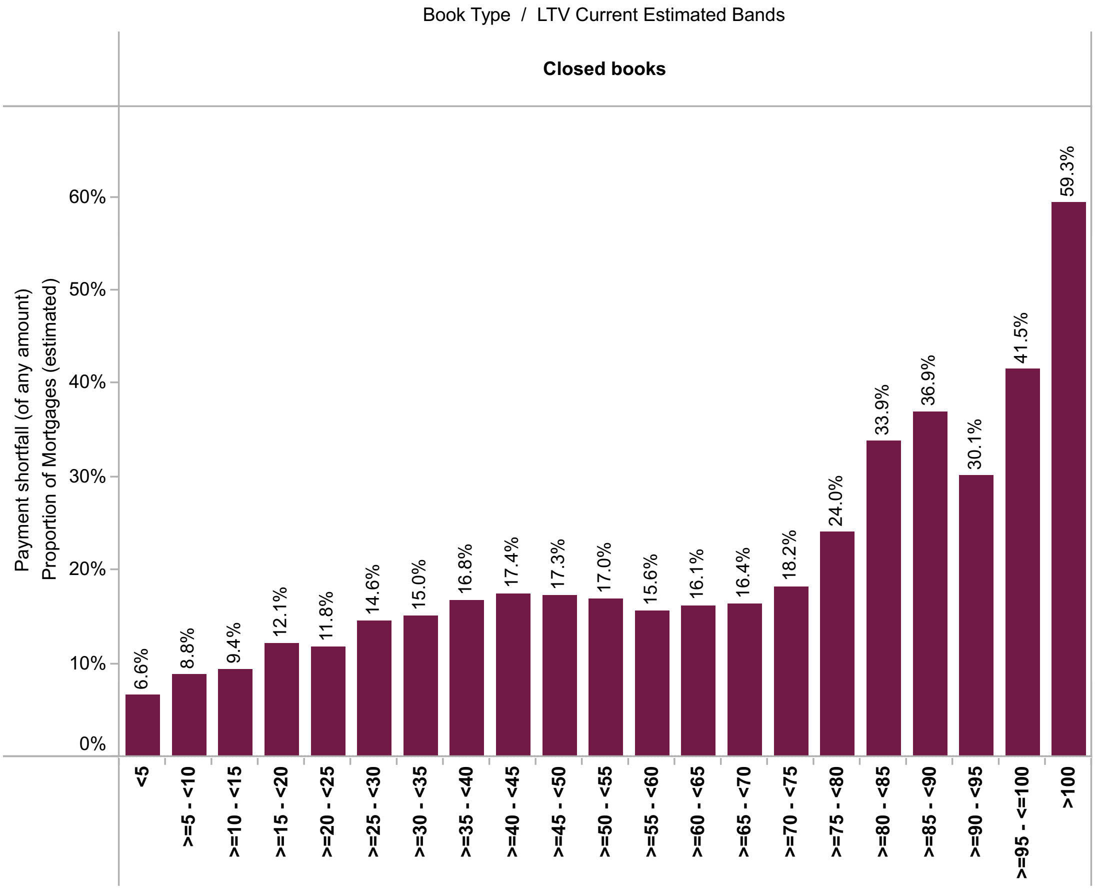
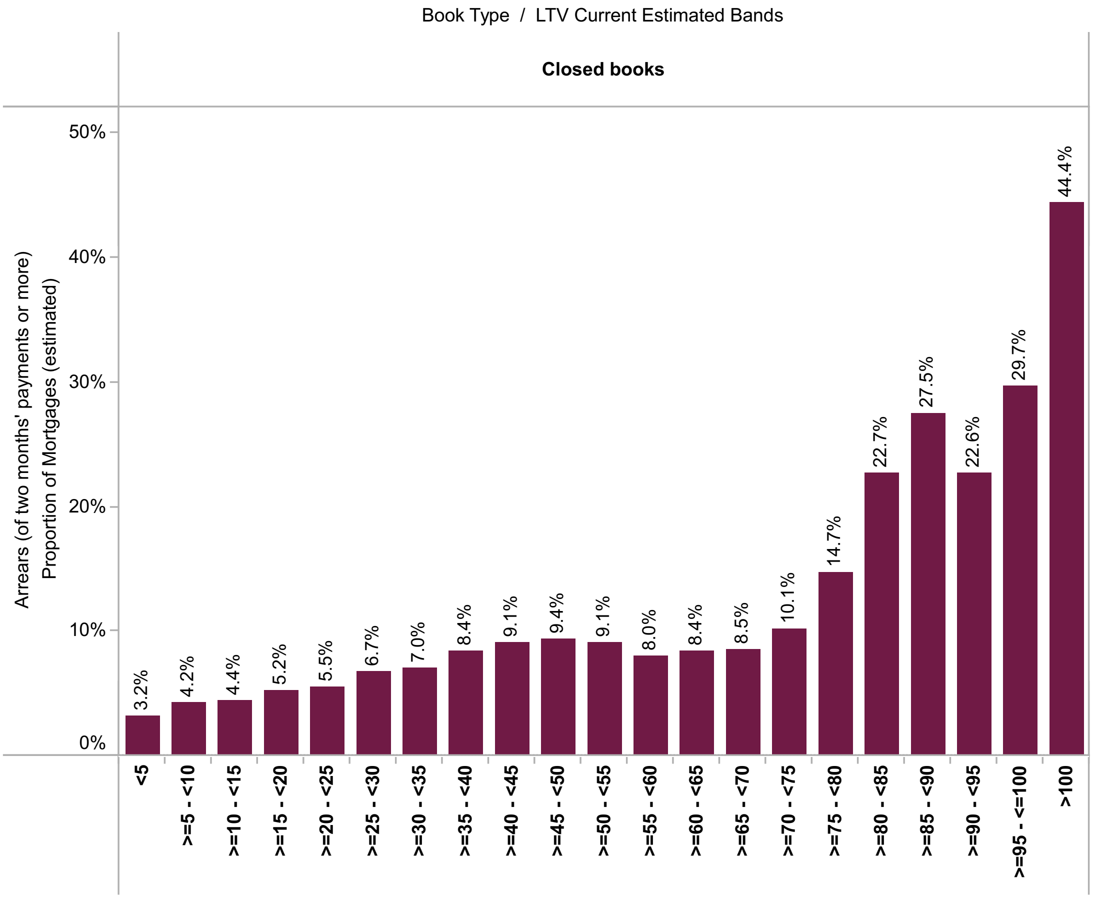


Figure 22. Proportion of mortgages in closed books with current mortgage arrears (shortfall of two months' payments or more), by LTV band



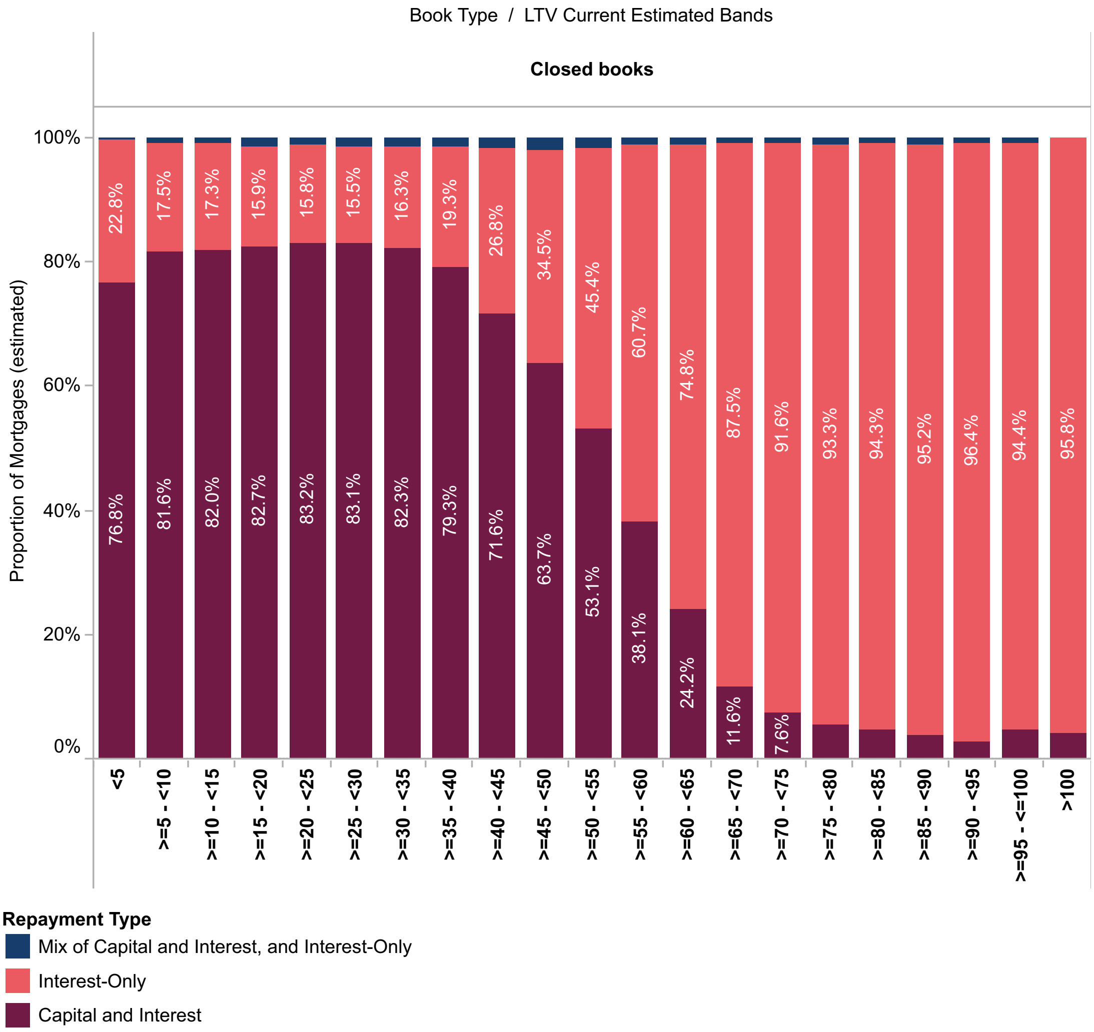
LTV and repayment type

63. Closed book mortgages in higher LTV bands are much more likely to be interest-only mortgages than at lower LTVs. Over 90% of closed book mortgages in the LTV bands above 70% LTV are interest-only (see figure 23).

64. This is unsurprising, given that most closed book mortgages were originated in 2008 or before. So, for the capital and interest mortgages a significant amount of capital should have been repaid over the term, reducing the LTV. Whereas for interest-only mortgages, the balance stays the same over the term, and LTV will only fall where the value of the property has increased.

65. However, while most (83%) of closed book interest-only mortgages have an LTV of 50% or more, the remaining 17% are under 50% LTV. (Although there is a possibility that some of these borrowers may have a mortgage that has linked unsecured borrowing that in effect increases their overall LTV position. For example, borrowers who originally had a 'Together' mortgage. This was a product offered by Northern Rock that allowed a maximum LTV of 125%, with the unsecured element provided as a linked personal loan, and one interest rate across the combined product).

Figure 23. Proportion of mortgages in closed books by repayment type and LTV band



Regional analysis

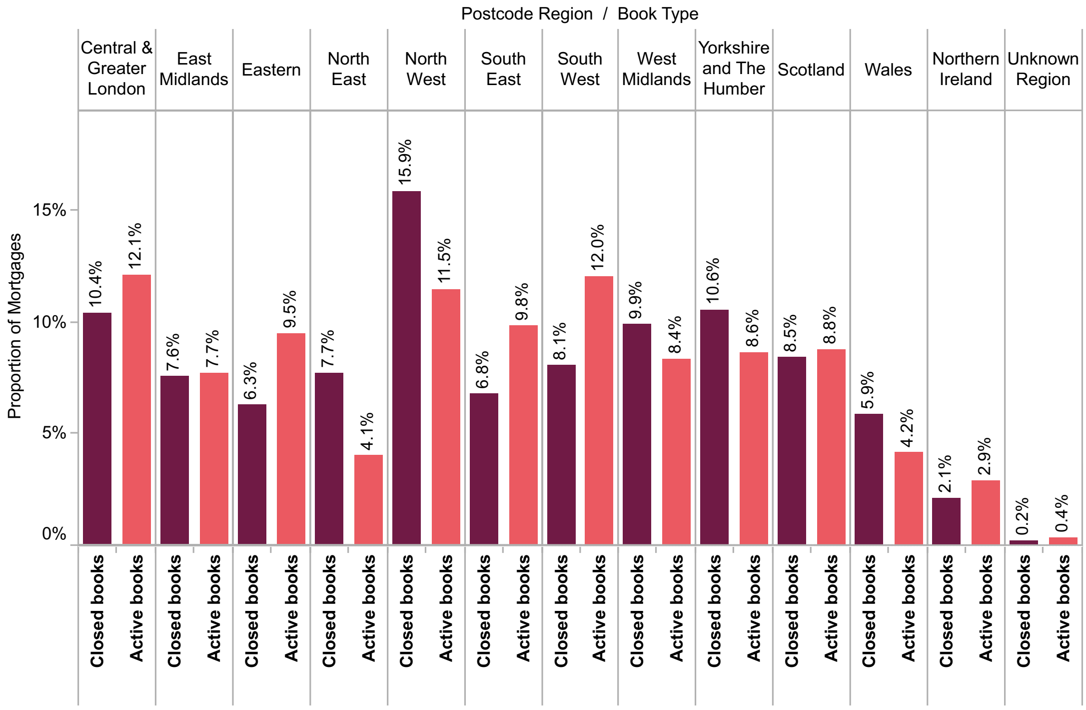
Note: Data for figures 26-29 was extracted from our live data systems in the seven days commencing 6 November 2021, whereas data for other charts was extracted in the seven days commencing 23 October 2021.

Regional distribution

66. Closed book mortgages are distributed across the UK regions in a broadly similar way to active book mortgages. However, some regions, particularly in the north of England, have a higher proportion of closed book mortgages when compared to the distribution of active book mortgages. For example, in the North East, North West, West Midlands, and Yorkshire and the Humber. This is also true for Wales.

67. The chart below which shows the regional distribution of closed book and active book mortgages.

Figure 24. Proportion of mortgages by region, closed books and active books



LTV by region

68. The distribution of closed book mortgages in each LTV band is broadly similar across all regions, with the following exceptions:

- There is a higher proportion of closed book mortgages in the LTV bands of 80% and above in the North East region.
- Some regions in the south of England have a higher proportion in the 60-75% LTV bands i.e. London, East, South East and South West.

Figure 25. Proportion of mortgages by region and LTV band, closed books and active books

		LTV Current Estimated Bands								
Postcode Region	**Book Type**	**<50**	**>=50 - <60**	**>=60 - <75**	**>=75 - <80**	**>=80 - <85**	**>=85 - <90**	**>=90 - <95**	**>=95 - <=100**	**>100**
Central & Greater London	Closed books	30.4%	12.3%	46.2%	7.2%	2.2%	0.8%	0.4%	0.2%	0.3%
	Active books	60.0%	13.9%	18.2%	4.3%	2.3%	0.8%	0.2%	0.0%	0.1%
East Midlands	Closed books	46.5%	14.8%	30.4%	5.8%	1.8%	0.4%	0.2%	0.0%	0.0%
	Active books	49.9%	15.0%	23.2%	6.2%	3.7%	1.3%	0.4%	0.1%	0.1%
Eastern	Closed books	38.3%	13.5%	38.6%	6.3%	2.4%	0.5%	0.3%	0.1%	0.1%
	Active books	54.7%	14.4%	20.7%	5.4%	3.2%	1.1%	0.3%	0.0%	0.1%
North East	Closed books	38.1%	11.2%	22.8%	7.5%	7.5%	6.1%	4.2%	1.9%	0.7%
	Active books	41.1%	14.4%	26.8%	8.9%	5.7%	2.1%	0.7%	0.1%	0.1%
North West	Closed books	47.3%	14.6%	29.3%	5.7%	2.2%	0.5%	0.2%	0.1%	0.1%
	Active books	48.4%	15.0%	23.8%	6.6%	4.1%	1.5%	0.4%	0.1%	0.1%
South East	Closed books	34.8%	13.2%	41.5%	7.3%	2.2%	0.6%	0.2%	0.1%	0.1%
	Active books	55.7%	14.5%	20.2%	5.1%	2.9%	1.0%	0.3%	0.0%	0.0%
South West	Closed books	38.3%	13.7%	39.3%	6.0%	2.0%	0.4%	0.3%	0.0%	0.1%
	Active books	54.6%	14.6%	20.8%	5.4%	3.0%	1.0%	0.3%	0.0%	0.0%
West Midlands	Closed books	47.5%	13.5%	31.1%	5.5%	1.8%	0.4%	0.1%	0.0%	0.0%
	Active books	50.9%	14.9%	22.7%	6.1%	3.6%	1.2%	0.3%	0.0%	0.1%
Yorkshire and The Humber	Closed books	50.1%	15.0%	27.5%	4.9%	1.9%	0.4%	0.1%	0.0%	0.1%
	Active books	48.4%	14.9%	23.7%	6.8%	4.1%	1.5%	0.4%	0.1%	0.1%
Wales	Closed books	45.9%	14.6%	30.5%	6.3%	2.0%	0.4%	0.1%	0.1%	0.1%
	Active books	48.6%	15.1%	23.4%	6.7%	4.1%	1.5%	0.4%	0.1%	0.1%
Scotland	Closed books	53.2%	14.6%	23.5%	5.5%	2.3%	0.6%	0.2%	0.1%	0.1%
	Active books	49.5%	14.7%	23.6%	6.8%	3.6%	1.2%	0.3%	0.1%	0.0%
Northern Ireland	Closed books	58.8%	13.4%	22.4%	2.2%	1.1%	0.9%	0.5%	0.2%	0.5%
	Active books	53.0%	14.0%	21.0%	6.4%	3.7%	1.3%	0.3%	0.1%	0.1%
Unknown Region	Closed books	46.0%	14.6%	31.9%	4.9%	2.2%		0.4%		
	Active books	55.3%	14.2%	21.0%	5.2%	3.0%	0.8%	0.2%	0.0%	0.2%

Payment difficulties by region

Mortgage payment shortfalls (of any amount)

69. 17.2% of closed book mortgages have a current payment shortfall. Most regions have broadly similar levels of payment shortfalls, mostly between 15% and 19%.

70. Northern Ireland has the highest proportion, with 28.2%.

Figure 26. Proportion of mortgages by region with a current payment shortfall (of any amount), closed books and active books

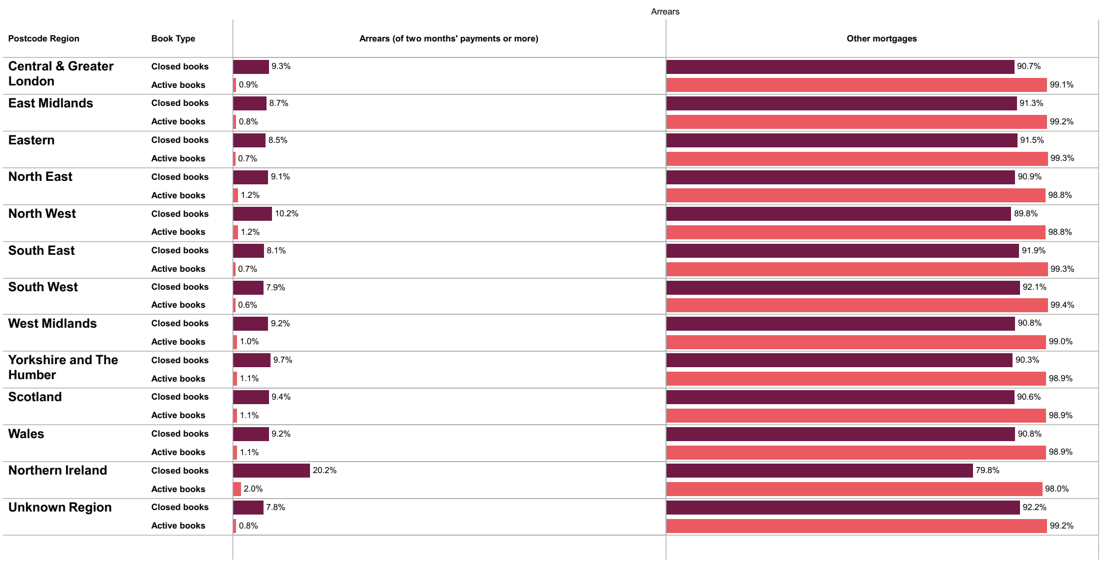
		Payment Shortfall	
Postcode Region	**Book Type**	**Payment shortfall (of any amount)**	**No payment shortfall**
Central & Greater London	Closed books	16.2%	83.8%
	Active books	2.1%	97.9%
East Midlands	Closed books	16.5%	83.5%
	Active books	2.0%	98.0%
Eastern	Closed books	16.2%	83.8%
	Active books	1.8%	98.2%
North East	Closed books	16.7%	83.3%
	Active books	2.7%	97.3%
North West	Closed books	18.6%	81.4%
	Active books	2.6%	97.4%
South East	Closed books	15.4%	84.6%
	Active books	1.8%	98.2%
South West	Closed books	15.1%	84.9%
	Active books	1.5%	98.5%
West Midlands	Closed books	17.6%	82.4%
	Active books	2.3%	97.7%
Yorkshire and The Humber	Closed books	18.0%	82.0%
	Active books	2.4%	97.6%
Scotland	Closed books	16.8%	83.2%
	Active books	2.2%	97.8%
Wales	Closed books	17.6%	82.4%
	Active books	2.5%	97.5%
Northern Ireland	Closed books	28.2%	71.8%
	Active books	3.5%	96.5%
Unknown Region	Closed books	13.1%	86.9%
	Active books	1.8%	98.2%

Mortgages in arrears (shortfall of two months' payments or more)

71. The pattern here is similar to payment shortfalls. 9.4% of closed book mortgages have current mortgage arrears. There is generally little variation between regions, with most regions having between 7.5% and 10% of mortgages in arrears.

72. Northern Ireland once again has the highest proportion, with 20.2% of closed book accounts in arrears.

Figure 27. Proportion of mortgages by region with current mortgage arrears (shortfall of two months' payments or more), closed books and active books



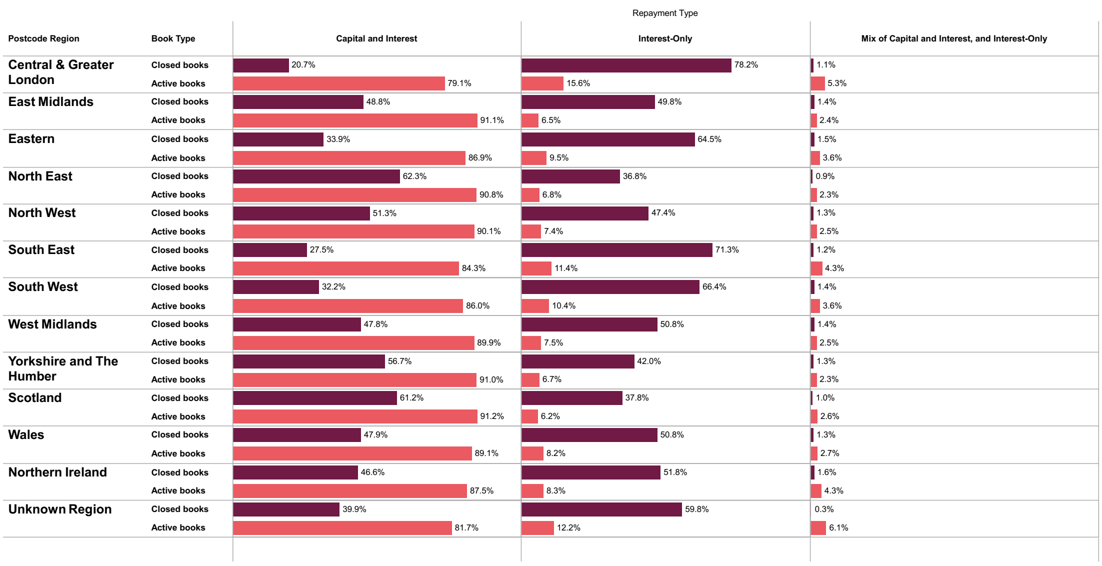
Repayment type by region

73. 53.5% of closed book mortgages are interest-only. Regions in the south of England tend to have a higher proportion than this. For example, Central and Greater London have 78.2%, South East has 71.3%, South West has 66.4%, and Eastern has 64.5%.

74. The regions with the lowest proportion of closed book mortgages on an interest-only basis are North East (36.8%), and Scotland (37.8%).

75. All other regions fall between 40% and 60%.

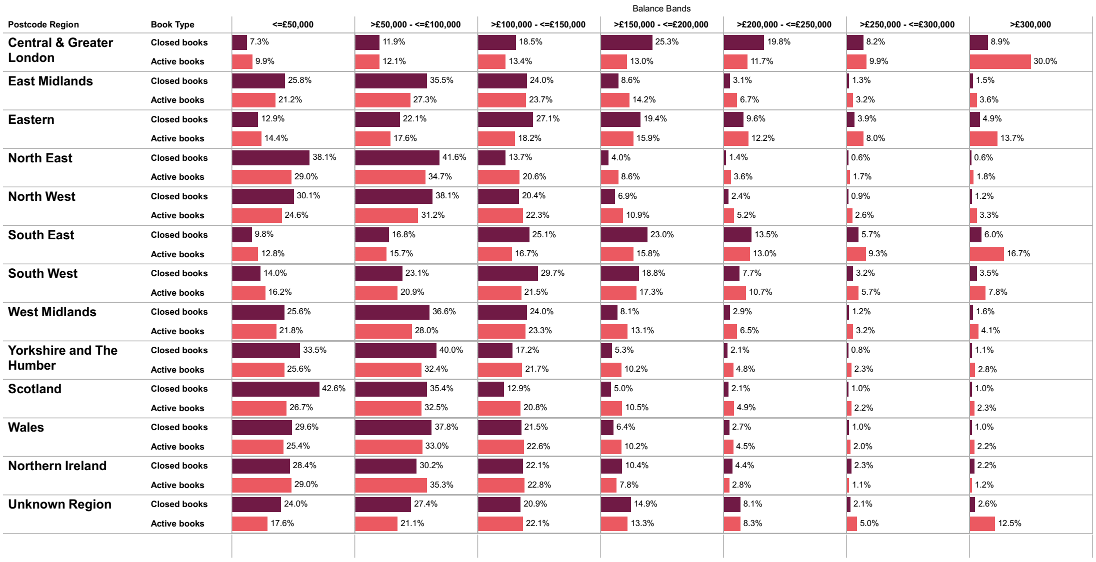
Figure 28. Proportion of mortgages by region and repayment type, closed books and active books



Outstanding balance by region

76. Closed book mortgages in regions of the south of England tend to have higher outstanding balances than other areas, presumably reflecting the higher property prices in these regions.

Figure 29. Proportion of mortgages by region and current outstanding balance, closed books and active books



Section D. Characteristics at origination (i.e. at the point of sale)

77. To help us understand the characteristics of the closed and active book mortgages at origination, we need to match each mortgage record from PSD007 in H1 2021 with the record of its original sale in PSD001. We could not match all mortgages with their sale records, for various reasons (explained in the technical note in Section G of this annex). But we could match 74% of closed book mortgages and 87% of active book mortgages. Therefore, the figures in this section are estimates, scaled up from the matched sample. We then looked at the characteristics of those mortgages at origination.

78. We looked at the prevalence of certain characteristics which have previously been associated with a higher risk of payment difficulties. (For example, in the analysis that our predecessor body the Financial Service Authority undertook for the Mortgage Market Review in the consultation papers CP10/16 and CP11/31). We then compared the proportion of these characteristics in closed and active book mortgages.

79. Closed book mortgages have a higher proportion of these characteristics (see figures 30-33):

- Where income was not verified at origination (46.3% compared with 11.1% of active book mortgages)
- Mortgages advanced to consumers with an impaired credit status at origination (19.7% compared with 0.8% of active book mortgages)
- Mortgages advanced to consumers who were self-employed (28.2% compared with 12.4% of active book mortgages).
- Mortgages advanced for properties purchased under the Right to Buy (RTB) scheme (3.5% compared with 1.1% of active book mortgages)

80. It is unsurprising that closed book mortgages have more of these characteristics, given that they were predominantly originated in the period up to 2008, before lender risk appetites and regulatory expectations tightened following the financial crisis. Whereas active book mortgages are much more likely to have been originated after then, when lending standards were tighter.

Figure 30. Proportion of mortgages where income was not verified at origination, closed books and active books

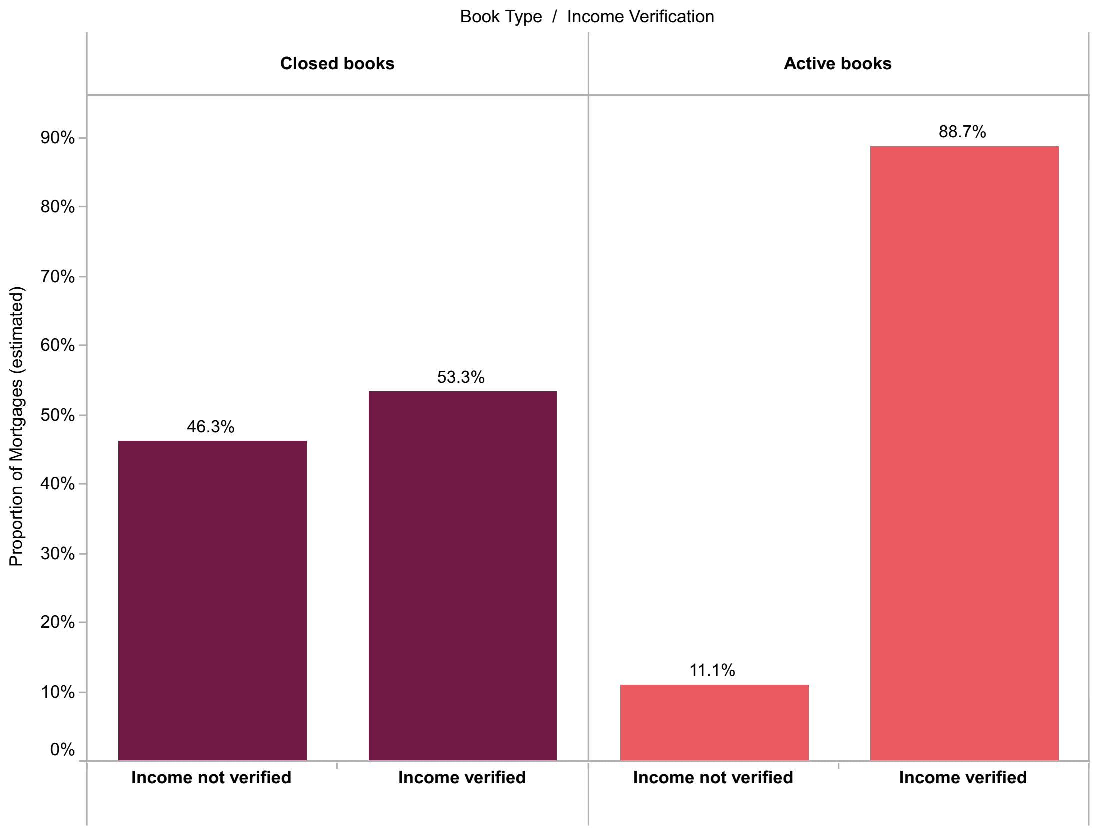


Figure 31. Proportion of mortgages advanced to consumers with an impaired credit status, closed books and active books

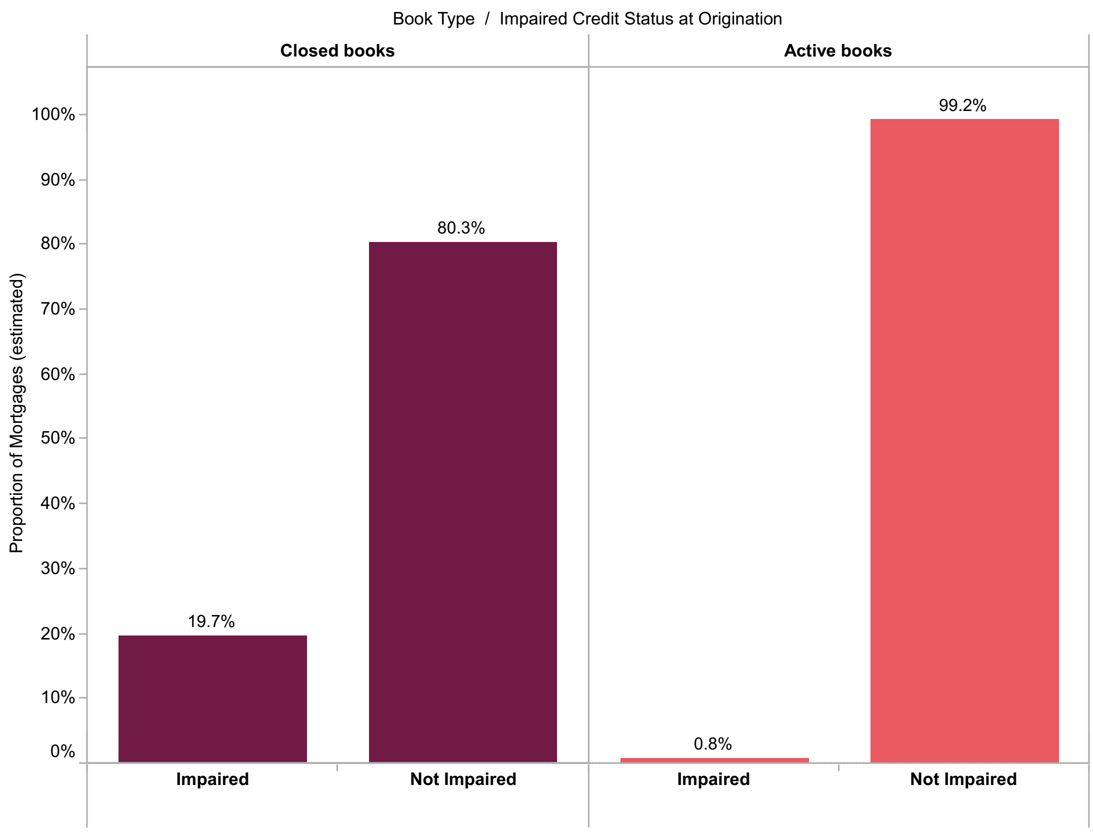


Figure 32. Proportion of mortgages where the borrower was reported as being self-employed, closed books and active books

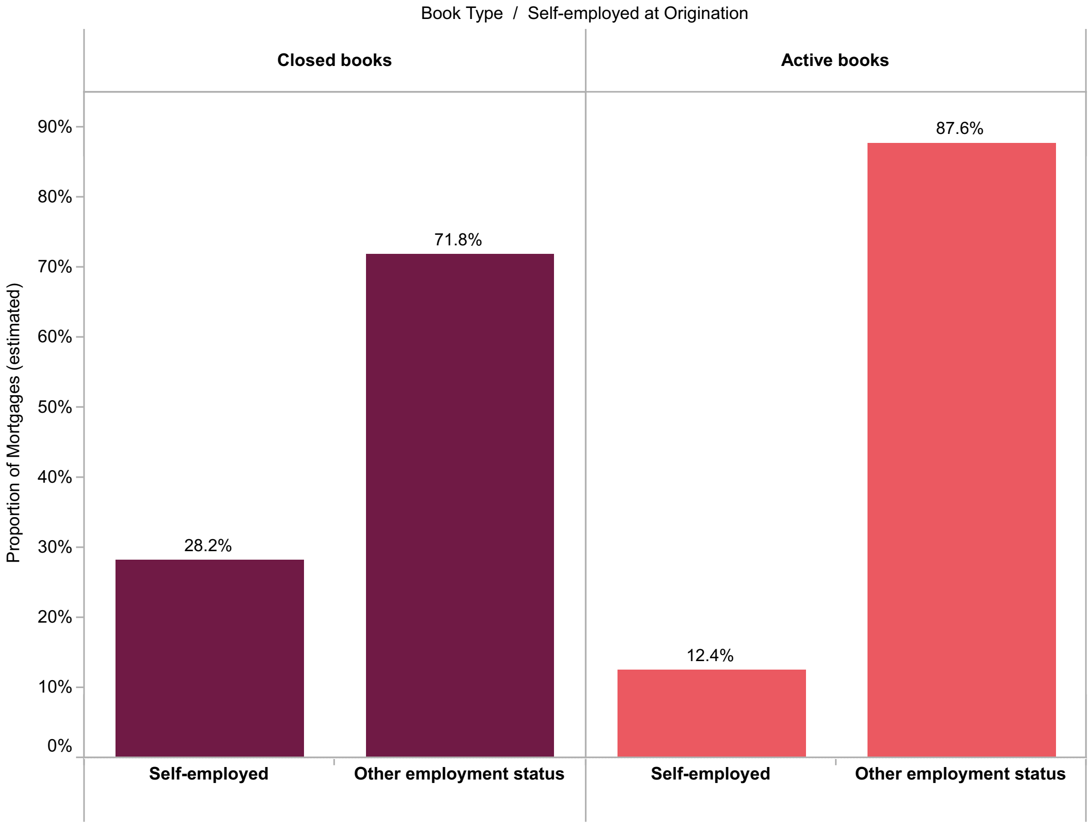
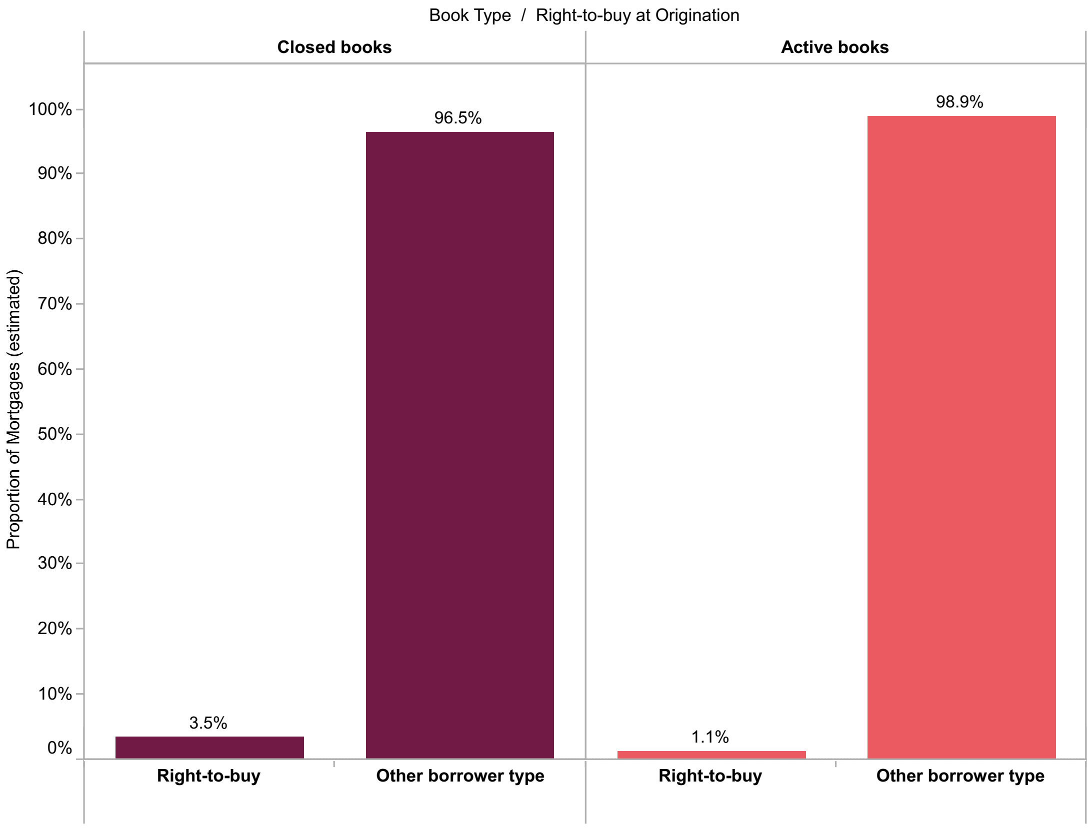


Figure 33. Proportion of mortgages advanced for properties purchased under the Right to Buy scheme, closed books and active books



Characteristics at origination, by repayment type

81. Closed book mortgages with the above characteristics at origination tend to have a high proportion of interest-only (with the exception of RTB mortgages), and in all cases closed book mortgages with these characteristics have a significantly higher proportion of interest-only than active book mortgages (see figures 34-37).

- 64.7% of closed book mortgages where income was not verified are interest-only, compared with 26.1% of active book mortgages where income was not verified.
- 54.1% of closed book impaired credit mortgages are interest-only, compared with 22.4% of active book impaired credit mortgages.
- 66.9% of closed book self-employed mortgages are interest-only, compared with 17.7% of active book self-employed mortgages.
- 39.8% of closed book RTB mortgages are interest-only, compared with 2.9% of active book RTB mortgages.

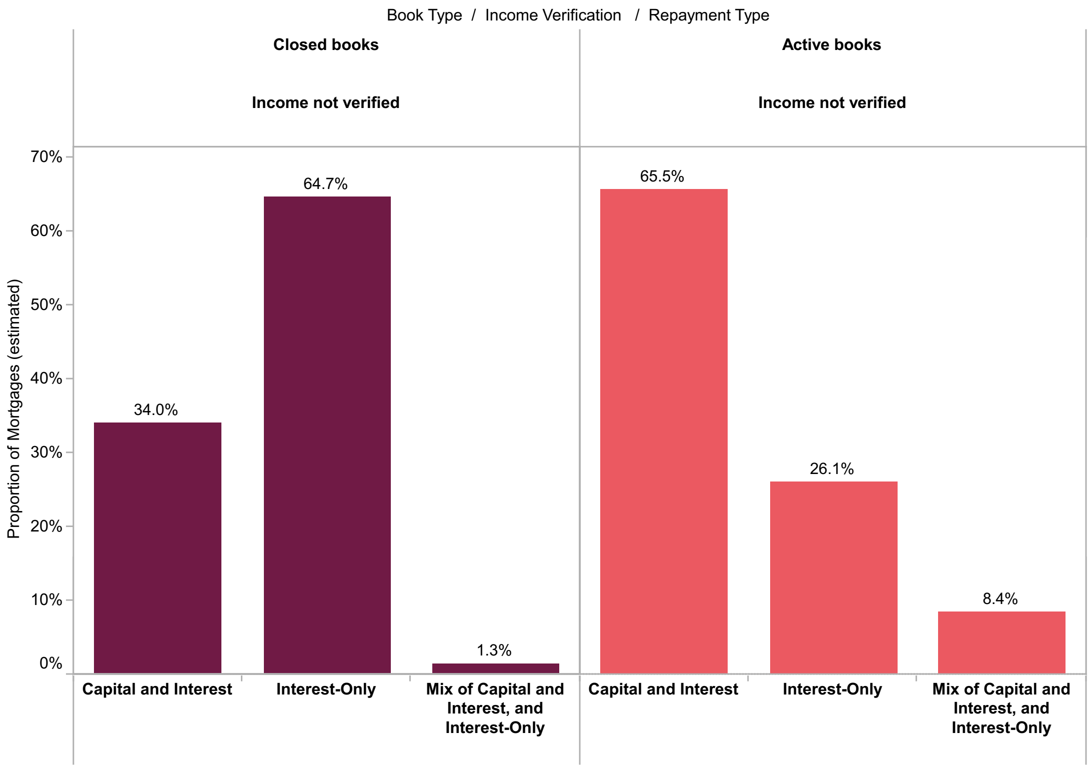
82. Further details are as follows:

a) income verification, by repayment method

83. 64.7% of closed book mortgages where the borrowers' incomes were not verified at origination are interest-only. 1.3% are part capital and interest and part interest-only. 34% are capital and interest.

84. In active books, 26.1% are interest-only, 8.4% are part and part, and 65.5% are capital and interest.

Figure 34. Proportion of mortgages where income was not verified at origination, by repayment type, closed books and active books

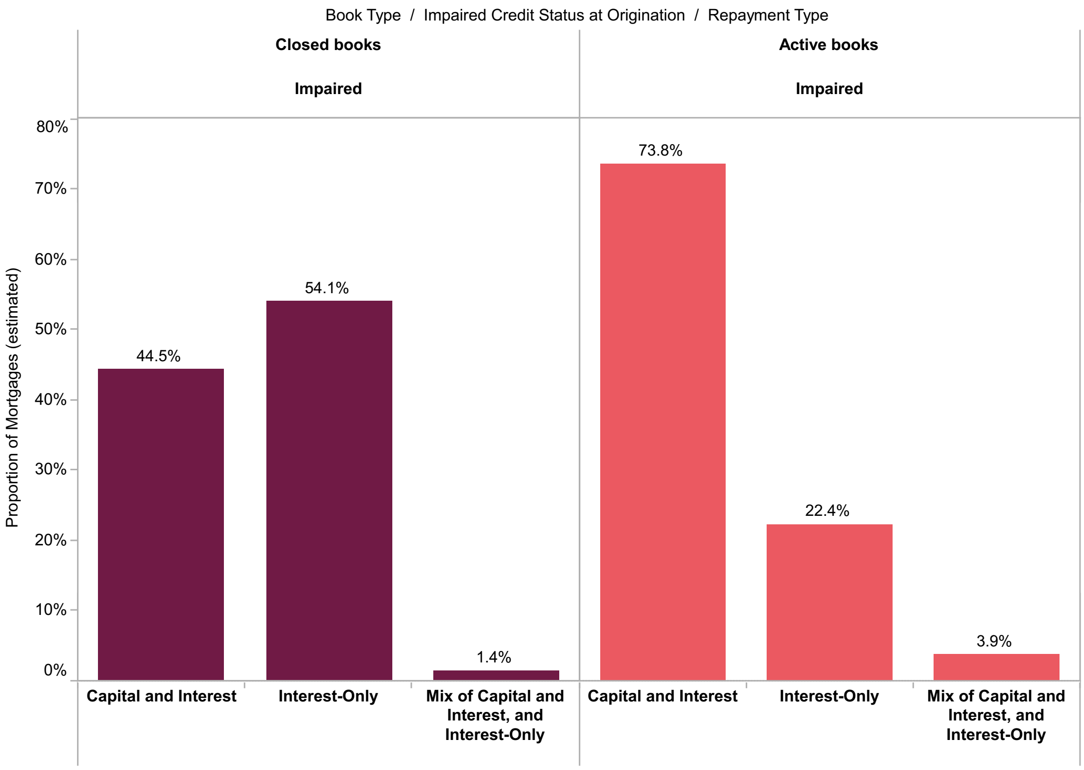


b) credit impaired by repayment method

85. 54.1% of closed book mortgages to credit-impaired borrowers are interest-only. 1.4% are part capital and interest and part interest-only. 44.5% are capital and interest.

86. In active books, 22.4% are interest-only. 3.9% are part capital and interest and part interest-only, and 73.8% are capital and interest.

Figure 35. Proportion of mortgages advanced to consumers with an impaired credit status, by repayment type, closed books and active books

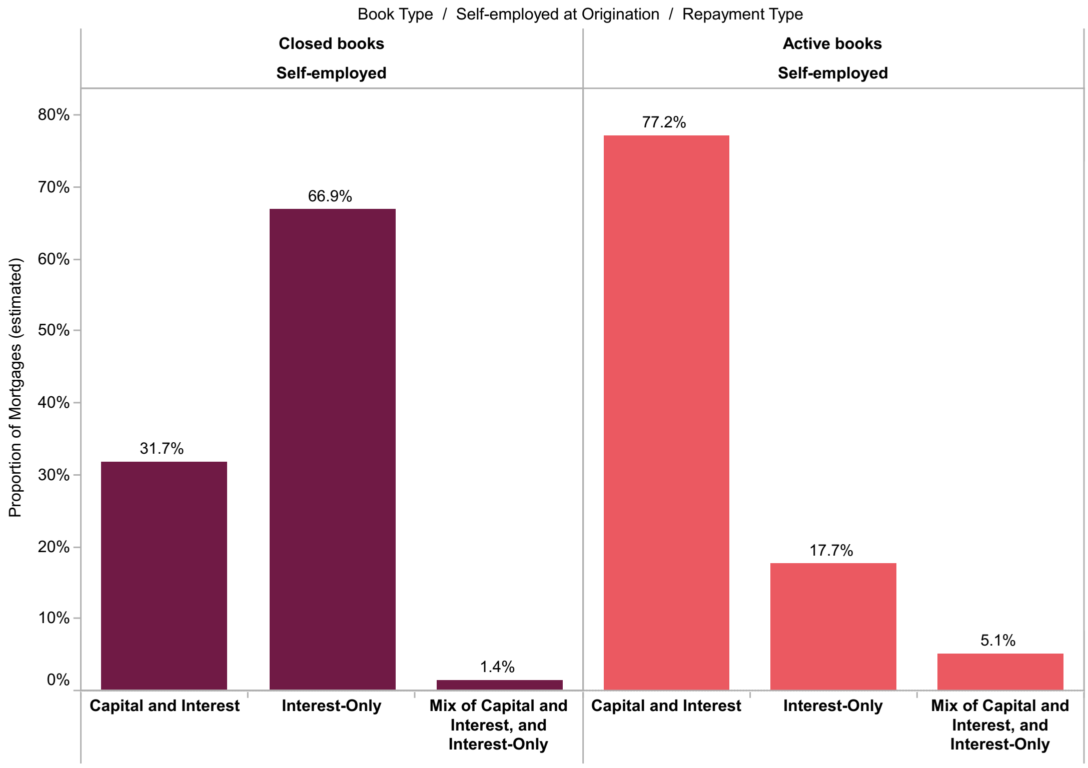


c) Self-employed, by repayment method

87. 66.9% of closed book mortgages for self-employed borrowers are interest-only. 1.4% are part capital and interest and part interest-only. 31.7% are capital and interest.

88. In active books, 17.7% of mortgages to self-employed borrowers are interest-only. 5.1% are part capital and interest and part interest-only. 77.2% are capital and interest.

Figure 36. Proportion of mortgages where the borrower was reported as being self-employed, by repayment type, closed books and active books

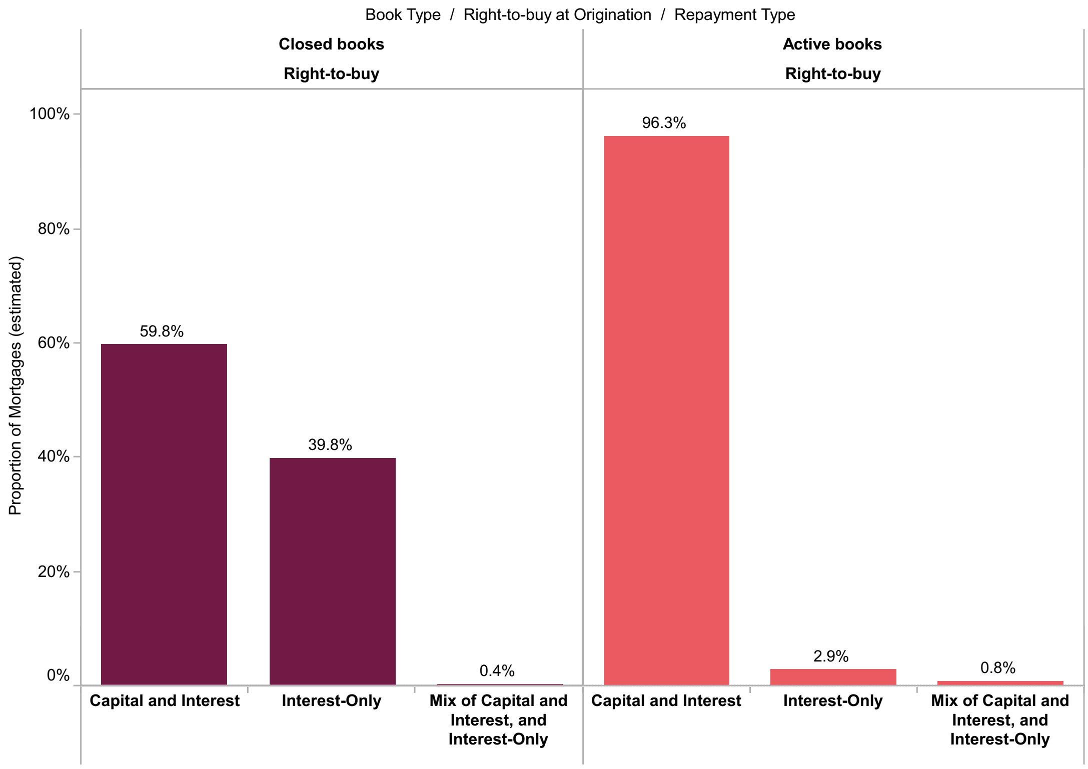


d) Right to buy, by repayment method

89. 39.8% of closed book RTB mortgages where the borrowers' incomes were not verified at origination are interest-only. 0.4% are part capital and interest and part interest-only. 59.8% are capital and interest.

90. In active books, 2.9% are interest-only, 0.8% are part and part, and 96.3% are capital and interest.

Figure 37. Proportion of mortgages advanced for properties purchased under the Right to Buy scheme, by repayment type, closed books and active books



Section E. Segmentation analysis

91. We have broken down the population of closed book mortgages into segments, to help understand the size of each. Figure 38 is a summary of this, showing the breakdown by current characteristics (as of 30 June 2021) of the closed book population by LTV bands, current age of main borrower (i.e. first borrower), and remaining term – further split according to repayment type, and whether the mortgage has a current payment shortfall or not.

92. A more detailed breakdown is available on our website in excel format. This shows the size of the different segments when these factors (LTV, current age and remaining term) are combined, as well as by current interest rate. The size of each segment is shown by the number of mortgages in each segment, and also by the combined current balances of mortgages.

Figure 38. Closed book customer segments – summary table.

		Interest-only, with no current mortgage payment shortfall	Capital and interest, with no current mortgage payment shortfall	Interest-only, with current mortgage payment shortfall	Capital and interest, with current mortgage payment shortfall	Total
LTV, %	Unmatched	22,330	18,799	4,854	4,226	***50,209***
	<50	12,820	41,163	1,218	7,758	***62,959***
	>=50 – <60	9,384	7,279	1,578	1,650	***19,891***
	>=60 – <75	33,598	5,159	6,577	1,308	***46,642***
	>=75	10,109	531	4,067	226	***14,933***
	Total	***88,241***	***72,931***	***18,294***	***15,168***	***194,634***
Current age of main borrower, years	Up to 50	36,269	35,860	7,734	7,752	***87,615***
	51 – 55	17,346	14,221	3,942	3,100	***38,609***
	56 – 60	15,579	11,837	3,107	2,286	***32,809***
	61 – 65	9,862	6654	2,115	1334	***19,965***
	66+	9,185	4,359	1,396	696	***15,636***
	Total	***88,241***	***72,931***	***18,294***	***15,168***	***194,634***
Remaining term, years	<5	14,826	11,127	2,590	1,462	***30,005***
	>=5 – <10	27,683	19,813	5,745	4,532	***57,773***
	>=10 – <15	36,137	22,193	8,086	5,232	***71,648***
	>=15	9,595	19798	1,873	3942	***35,208***
	Total	***88,241***	***72,931***	***18,294***	***15,168***	***194,634***

Note: the 'unmatched' line in the LTV section represents mortgages in the H1 2021 data that can't be matched with its original sale record, which we need to do to estimate current LTV.

Section F. Closed book mortgages that remortgaged during H1 2021

93. We looked at closed book mortgage accounts reported as being closed during the six month period of H1 2021. We then looked to see if we could find these borrowers remortgaging with other lenders in the sales data covering the same period.

94. (Note that we are not able to identify in our data borrowers who changed their mortgage when they moved home, rather than remortgaging their existing home. This is because we use the property postcode to identify matches between the original and new mortgage. So this analysis is focused only on remortgaging).

95. In total, 20,486 of the closed book mortgage accounts were reported as being closed in H1 2021. We found 2,201 of these with remortgages reported in the sales data during the same period, indicating that they had been able to get a mortgage with another lender.

96. They remortgaged to a wide range of other firms.

97. 80 of these remortgages (3.6%) were reported as having used the 'modified affordability assessment'. This suggests that the rest passed normal affordability checks, i.e. in accordance with our responsible lending rules (MCOB 11).

98. These remortgages were not necessarily like-for-like switches. The borrowers may have changed the characteristics of their mortgages when they remortgaged. For example, while 63.9% of these mortgages were capital and interest before remortgaging, 93.1% of the new mortgages were capital and interest. This indicates that some borrowers who originally had an interest-only mortgage moved to a capital and interest mortgage.

Characteristics of the new mortgages

99. Of the closed book borrowers that remortgaged:

- 93.1% took a capital and interest mortgage
- 97.7% took a fixed rate
- 86.9% moved to a rate of 2.99% or less
- 76.0% of the sales were made through an intermediary, and 24.0% directly through a lender

100. Further details are set out below.

Figure 39. Average characteristics of the new mortgages taken by borrowers previously in closed books, H1 2021

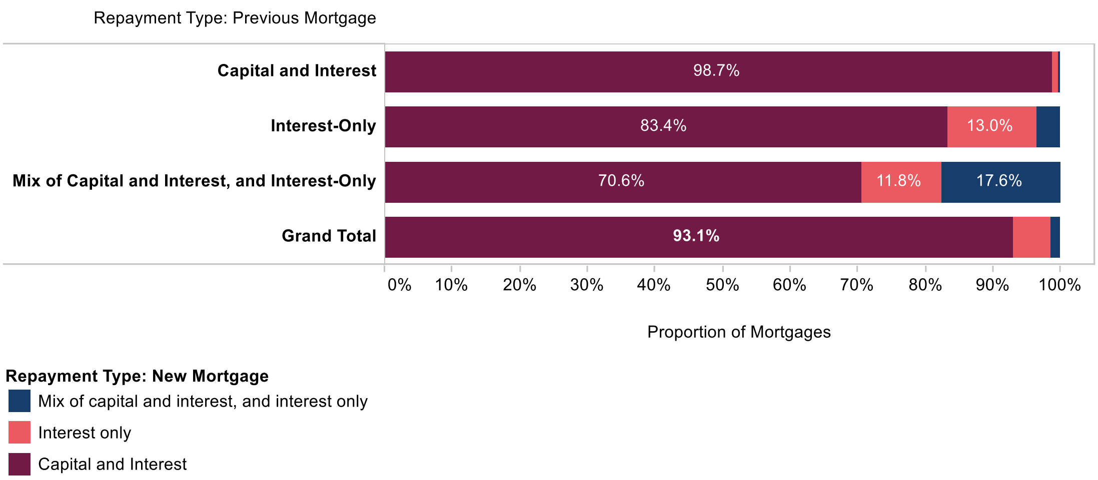
Median new mortgage value	£118,999
Median new mortgage loan-to-income (LTI)	2.5
Median new mortgage loan-to-value (LTV) (%)	64
Median new mortgage interest rate (%)	1.79
Median old mortgage interest rate (%)	4.14

Repayment type

101. The new mortgages were predominantly taken on a capital and interest basis (93.1%).

102. For borrowers that previously had an interest-only mortgage, 83.4% took a new mortgage that was capital and interest.

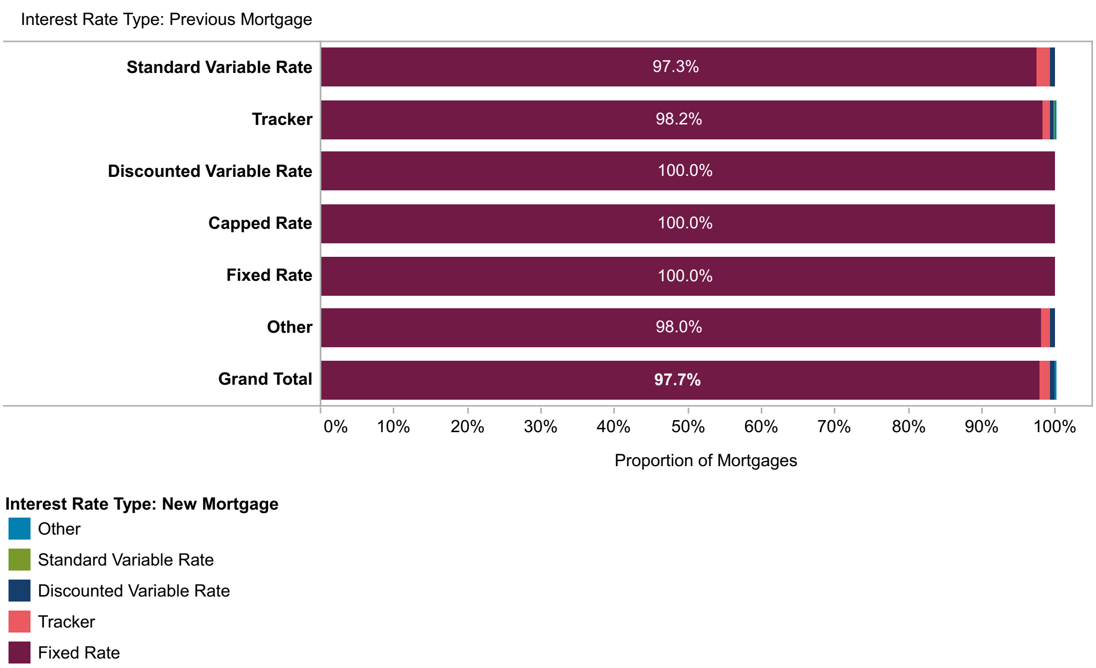
Figure 40. Proportion of mortgages by repayment type of new mortgage, closed book borrowers that remortgaged in H1 2021



Interest rate type

103. Nearly all (97.7%) moved to a fixed rate mortgage. 1.6% moved to a tracker rate, and 0.5% to a discounted variable rate.

Figure 41. Proportion of mortgages by interest rate type of new mortgage, closed book borrowers that remortgaged in H1 2021



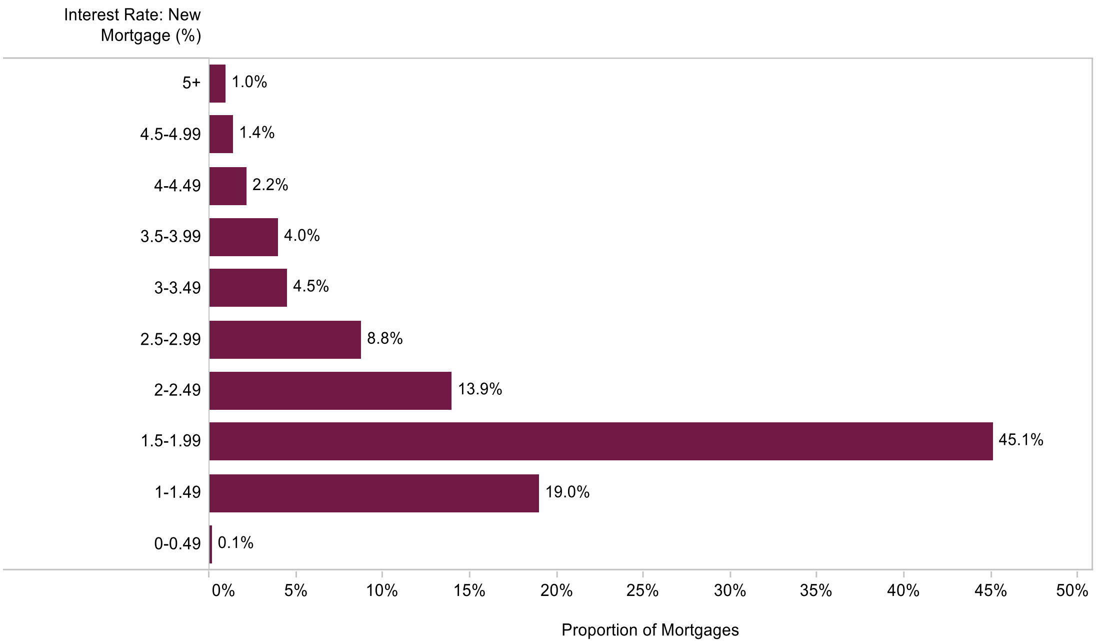
Interest rate

104. Most (86.9%) remortgaged to a rate below 3%.

105. Of the rest:

- 8.5% remortgaged to a rate of 3.00 to 3.99%.
- 3.6% remortgaged to a rate of 4.00-4.99%.
- Only 1.0% remortgaged to a rate of 5% or more.

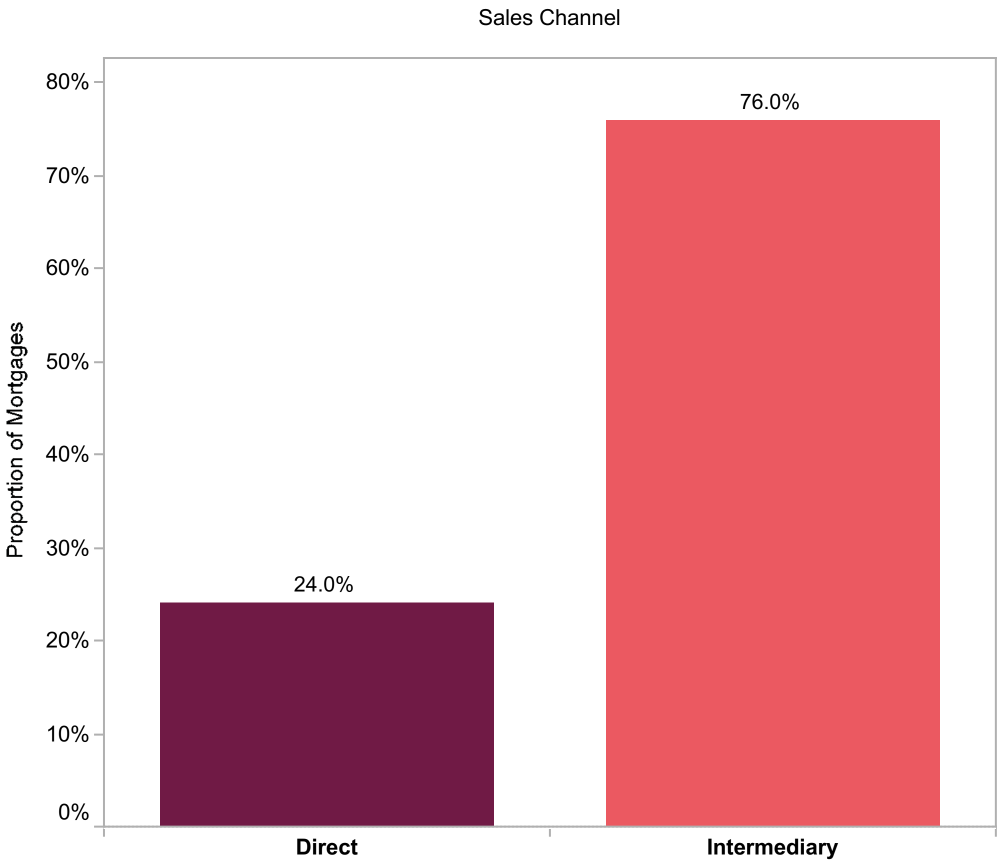
Figure 42. Proportion of mortgages by interest rate of new mortgage, closed book borrowers that remortgaged in H1 2021



Sales channel

106. The sales channel of the new mortgages reflected the same split as the wider population of remortgages during this period. 76% of the closed book remortgage sales were made through an intermediary, and 24% directly through a lender. Across the entire market, 75.1% of external remortgage sales were via an intermediary and 24.9% were purchased direct.

Figure 43. Proportion of mortgages by sales channel of new mortgage, closed book borrowers that remortgaged in H1 2021

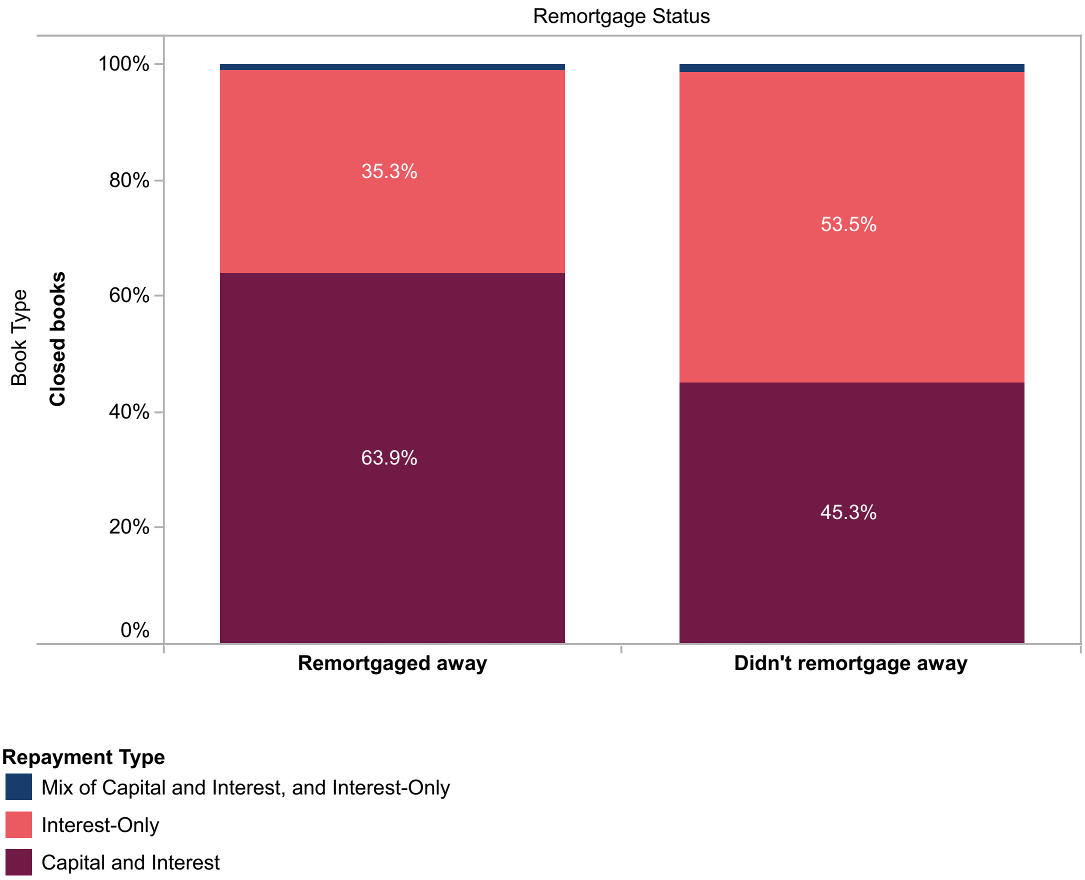


Characteristics of the original mortgages before remortgaging

Repayment type

107. Of those closed book mortgages that remortgaged away to another lender, 63.9% were capital and interest, and 35.3% were interest-only.

Figure 44. Proportion of mortgages by repayment type, closed book mortgages that did and didn't remortgage in H1 2021

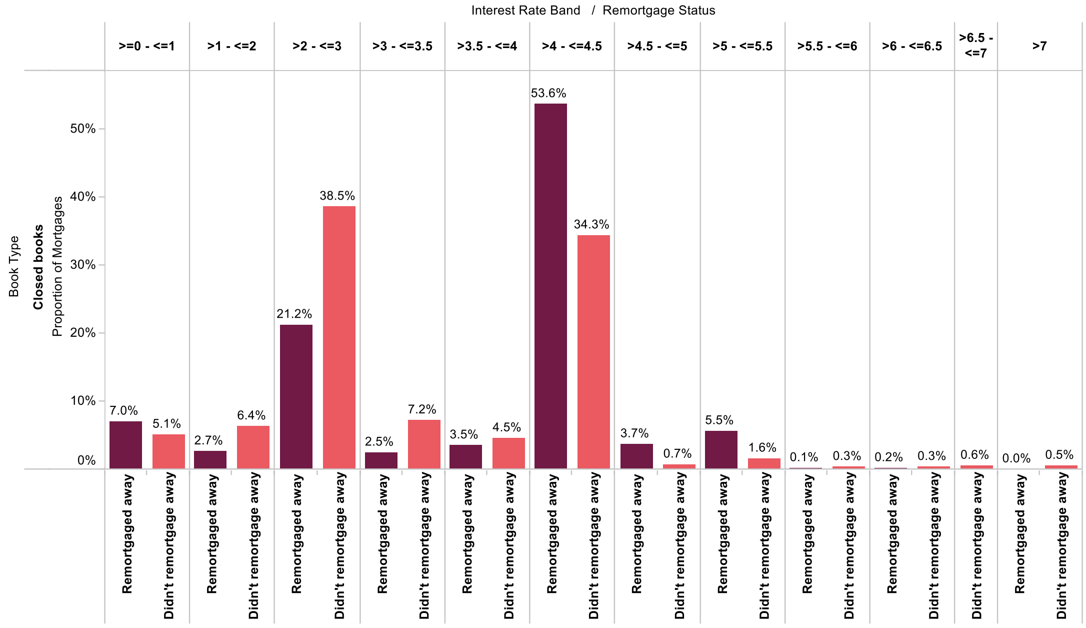


Interest rate on existing mortgage

108. A majority of borrowers (53.6%) that remortgaged away had been paying a rate of between 4% and 4.5% before they remortgaged. Of the others:

- 30.9% had been paying 3% or less
- 21.2% were paying between 2% and 3%
- 9.5% had been paying more than 4.5%

Figure 45. Proportion of mortgages by interest rate, closed book mortgages that did and didn't remortgage in H1 2021

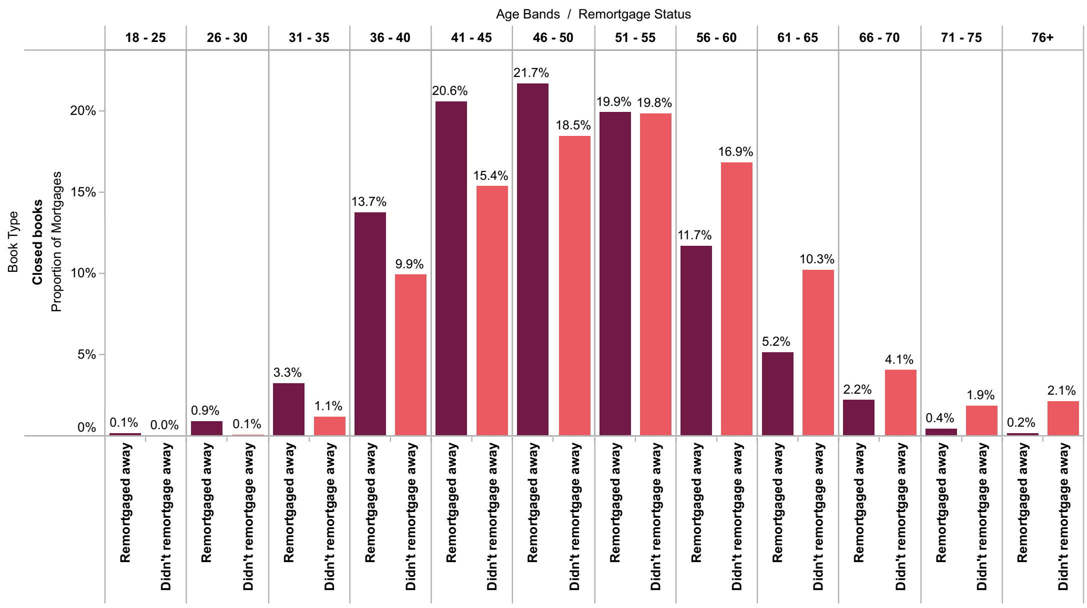


Age of main borrower

109. The borrowers that remortgaged away had a younger age profile than those that didn't:

- 80.2% were aged 55 or under, compared with 64.8% of those who didn't remortgage away.
- 91.9% were aged 60 or under, compared with 81.7% who didn't remortgage away.
- 8.0% were over 60, compared with 18.4% who didn't remortgage away.

Figure 46. Proportion of mortgages by age of main borrower, closed book mortgages that did and didn't remortgage in H1 2021



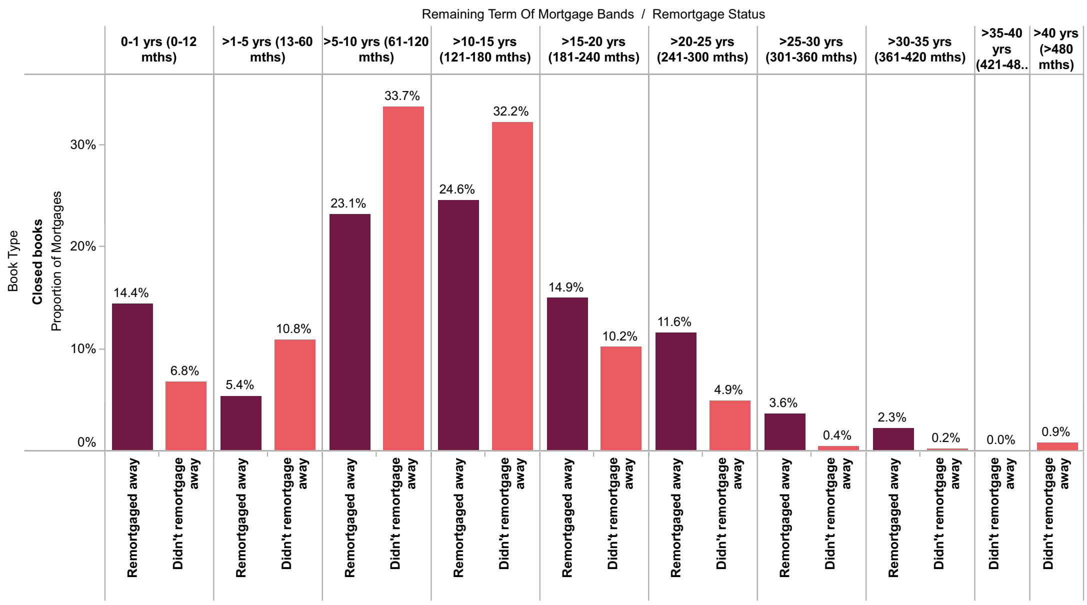
Remaining term

110. The borrowers that remortgaged away had mortgages with a wide range of remaining terms:

- 5.9% had more than 25 years
- 39.5% had between 10 and 20 years remaining
- 23.1% had between 5 and 10 years remaining
- 19.8% had 5 years or less remaining

111. Those borrowers with short remaining terms may have remortgaged over a longer term.

Figure 47. Proportion of mortgages by remaining term, closed book mortgages that and didn't remortgage in H1 2021



Section G. Technical note on data and methodology

112. In this annex, we provide a comparison of mortgages in closed books with inactive firms with mortgages in active books, as at 30 June 2021.

113. This analysis focuses on first charge regulated mortgage contracts, reported by firms in the regulatory return 'Product Sales Data: Mortgage Performance Data' (PSD007).

114. The analysis is based on data covering the half year period H1 2021 (i.e. 1 January 2021 to 30 June 2021), and reflects the position of the mortgages at the end of that period i.e. 30 June 2021. The data was extracted from our live data systems in the seven days commencing 23 October 2021 (unless otherwise stated).

115. We introduced a 'closed book' flag to PSD007 in the reporting period H1 2021, to enable us to identify mortgages held in closed books. This information is not available in previous reporting periods, and so was not used in previously published analysis.

116. As we wanted to focus this analysis on those borrowers who do not have switching options, we removed from the closed book dataset mortgages reported as being in a closed book but where we know the firm offers borrowers access to internal product switches (for example, intra-group switching).

117. We also excluded from our analysis second charge mortgages, and mortgages held by lifetime mortgage providers, because they are not included in the scope of this analysis due to the different way these products operate. We also removed mortgages which were redeemed during the reporting period (H1 2021).

118. The population of closed book mortgages included in this analysis is just under 195,000.

119. Throughout this analysis, we use the term 'closed book' mortgages as shorthand to refer to this population of 195,000 mortgages. We use the term 'active book' mortgages to refer to all other regulated mortgages reported in PSD007 (after deduction of second charge and lifetime mortgages) of which there are around 8.3 million. So closed book mortgages make up 2.3% of the total number of mortgages (8.5 million).

120. For some analysis, where we need to refer to the characteristics of the mortgage at the point of sale, such as the comparison of interest rate at origination with current interest rate (figure 9), consideration of LTVs, and analysis of the features of mortgages at origination (section D), we also use data from 'Product Sales Data: Mortgage Sales Data' (PSD001). This contains data on regulated mortgages at the point of sale. In such cases, we match mortgages contained in PSD007 with mortgages contained in PSD001.

Matching current mortgage records in PSD007 with the original record of sale in PSD001

121. We matched open mortgages in PSD007 in 2021 H1 to those mortgages in mortgage sales data, PSD001. PSD001 has information about the mortgage at the point of origination, which is necessary for us to be able to estimate a loan to value and certain characteristics of borrower at origination.

122. We are not, however, able to match all the mortgages. There are two reasons for this:

- PSD001 was first collected in Q2 2005. 17,000 mortgages in closed books and 326,000 mortgages in active books were opened before this and therefore we do not have the origination data for these mortgages.
- There is not a unique identifier for each mortgage across both datasets, so we match mortgages on data that should not change between origination and reporting in the last reporting period of PSD007. But if there are issues in the reporting of this data, for example, an incorrect or missing postcode or date of birth, then we cannot match the mortgage. We estimate around 33,000 mortgages in closed books and 772,000 mortgages in active books are impacted by this.

123. PSD007 and PSD001 are linked based on a unique key, which is created by concatenating full postcode, date of birth of the main borrower (i.e. first borrower) and origination date in both datasets. Each set is deduplicated before the match.

124. Where we use matched data, we then scale our matched sample to the remaining mortgages in the closed books and active books population (unless stated otherwise) using the relevant match rates detailed above, which are 74% for closed books and 87% for active books.

125. As some mortgages cannot be matched, these means that the numbers and proportions we report for some of the mortgage characteristics are estimates.

Calculating current LTVs

126. To estimate loan to value (LTV) for each mortgage, we need the current lending balance and the current property value.

127. We take the current lending balance as of 2021 H1 from PSD007.

128. We estimate the current property value by inflating the property value at the point of origination, which we take from PSD001. We use the HM Land Registry annual regional house prices to work out indices of house price change since the mortgage was sold, which we then use to inflate the property value at origination to the current property value.

129. We then estimate current LTV by calculating the current balance as of June 2021 as a percentage of the estimated current property value.

130. As explained above, because we need to match the current record from PSD007 with the original sale record reported in PSD001, we cannot match all accounts, which means that the numbers and proportions we report for LTVs are estimates.

Annex 2
An analysis of the number and characteristics of mortgage prisoners

1 Introduction

1.1 This Technical Annex contains our analysis of mortgage prisoners, their number and their characteristics. It explains how we have carried out the analysis by using three sets of data to identify mortgage prisoners from the population of mortgage borrowers in closed books with inactive firms: mortgage performance data (Product Sales Data: Mortgage Performance Data - PSD007); data from the original sale for mortgages in closed books (Product Sales Data: Mortgage Sales Data - PSD001); and a 10% sample of credit reference agency (CRA) files.

1.2 By merging these datasets, we have as complete a view as possible of a sample of borrowers in closed books.

1.3 By matching a sample of mortgages in closed books to credit reference data we can assess whether it is likely that a borrower could switch to an active lender. This is necessary to get to an estimate of the number of mortgage prisoners in closed books with inactive firms.

1.4 We define a mortgage prisoner as a borrower who is up to date with payments and:

- is unable to switch to a new mortgage deal (with a new lender or with their existing lender) and
- could potentially benefit from switching depending on their loan and borrower risk characteristics.

1.5 As of 30 June 2021, there are around 195,000 mortgages in the population of closed books with inactive firms (analysed at Annex 1). This represents 2.3% of the total number of residential mortgages (8.5 million). We focus on those borrowers who do not have switching options. The vast majority will have a mortgage in a closed book with an inactive firm. Therefore, we focus our analysis on the population of mortgages in closed books with inactive firms.

1.6 To estimate the number of mortgage prisoners within these 195,000 closed book mortgages, we remove the following mortgages from the closed books population:

- mortgages in payment shortfall
- mortgages near the end of their term (balance of less than £10,000 and/or a remining term of 2 years or less) as they would be unlikely to be able to switch to a new deal in the active market or materially benefit from doing so if they could
- mortgages whose borrowers have characteristics that suggest they are able to switch (they have a credit score high enough to be accepted by active lenders and less than 50% loan to value (LTV) on interest-only mortgages)
- mortgages whose borrowers have characteristics that suggest they are unable to switch, but who may not benefit from switching (because they are paying a rate lower than the lowest standard variable rate in the mainstream market).

1.7 This leaves around **47,000 mortgages held by mortgage prisoners** in the population of closed book mortgages with inactive firms. These borrowers are unable to switch and pay an interest rate on their mortgage of more than the lowest standard variable rate in the mainstream market. They are therefore more likely to benefit from switching, if they were able to. In our analysis mortgage prisoners are borrowers who are not eligible for a mortgage in the active market, given their risk characteristics. It follows that we cannot say what the risk reflective interest rate would be for these borrowers if they could switch.

1.8 We have undertaken sensitivity analysis to test how our estimate of mortgage prisoners is affected by changing our methodology (see Appendix 2) and do not see large changes in our estimate as a result.

1.9 We estimate that borrowers with those 47,000 mortgages are paying on average an interest rate of 4.32% (see section 3 for the distribution around this mean) and that:

- 29,000 (62%) have an interest-only mortgage
- 18,000 (38%) have a capital and interest repayment mortgage
- those on a capital and interest repayment mortgage have a median LTV of 51% while interest-only prisoners have a median LTV of 67%
- the total outstanding balance is around £5.5bn, with a median balance of £65,700 for capital and interest repayment mortgages and £127,000 on interest-only mortgages
- the median remaining term for mortgage prisoners is more than 10 years (10 years for interest-only mortgages and 15 years for repayment mortgages)
- 18% (c. 8,500) are in the most deprived areas in England (first decile, as defined by the Index of Multiple Deprivation).

1.10 There will be uncertainty in any estimate of mortgage prisoners because: it is a snapshot of borrowers and their situation may change, which affects their creditworthiness; we do not observe all the characteristics that might indicate a borrower can switch (for example, we do not have data on whether a borrower has had a payment shortfall but cleared it by the date of reporting, even though having had a recent payment shortfall might prevent them from switching); and it is based on a sample of borrowers, which has some limitations (see section 2 and Appendix 1 for detail).

1.11 Matching between different datasets means that the sample of mortgages we use for the analysis contains only a proportion of the population of c.195,000. Our estimate of mortgage prisoners and the assessment of their characteristics are based on that sample, ie on a sample of mortgages in the population of mortgages in closed books with inactive firms that is matched to a random sample of credit reference agency data.

1.12 We believe the sample is broadly representative of the wider closed book population and large enough to make inferences about it. We have looked carefully at the differences between the sample and the underlying population (for example because certain firms are missing from our sample) and adjusted for this when needed.

1.13 In Appendix 1 we compare the key characteristics of the sample against the characteristics of the wider closed book population and find that they are relatively similar, which gives us confidence in the representativeness of our sample. The main differences in the sample compared to the population are that the sample has a higher median interest rate and a lower proportion of interest-only mortgages. These differences have opposite effects on our estimate of mortgage prisoners. The former means we may be overestimating the true number of prisoners while the latter means we may be underestimating them.

1.14 We also compare the key characteristics of the mortgages from firms in our sample against those of firms not in our sample. There too we find they are similar. The main difference is that the missing firms charge lower interest rates, which implies we could be overestimating the number of prisoners.

1.15 Notwithstanding the inevitable limitations of a sample, matching different datasets provides a richer view of the position of these mortgages and their borrowers. Without this richer view we would not be able to produce an estimate of the number of mortgage prisoners and understand their mortgage and borrower characteristics. For example, in our analysis we consider the proportion of interest-only or capital and interest repayment mortgages held by mortgage prisoners, their outstanding balances and monthly payments, and how far or how close some of them might be to meeting lending criteria that may be acceptable to lenders.

1.16 We think that the differences we observe between the sample and the population are not large enough to materially influence our conclusions. We can be reasonably confident that around a quarter of the mortgages in closed books are held by mortgage prisoners.

1.17 The size of the sample, however, means that conclusions based on smaller segments of mortgage prisoners (discussed in the Segmentation section) need to be treated with appropriate caveats.

1.18 This note covers:

- The data and sample (section 2)
- Our approach to identifying mortgage prisoners (section 3)
  - including the interest rates they pay
- Our findings (section 4)
  - an analysis of mortgage prisoners:
    - **i.** their mortgage characteristics
    - **ii.** their borrower characteristics
  - segments of mortgage prisoners by key characteristics.

1.19 A more technical description of the data we have used, the process of matching the datasets and the characteristics of the matched sample are set out in Appendix 1. Appendix 2 sensitivity tests our results and shows how our estimate of mortgage prisoners differs if we use a different illustrative benchmark rate for identifying those who could potentially benefit from switching. It also shows how our estimate of mortgage prisoners is affected by changing key assumptions such as the maximum loan to value that enables an interest-only borrower to switch and the minimum credit score cut off that means a borrower cannot switch. Appendix 3 provides summary statistics for the 'able to switch' mortgages.

2 Data and sample

2.1 We identify the 195,000 mortgages in closed books with inactive firms using data from our mortgage performance data, PSD007 as of 30 June 2021. This is the same population of borrowers that we used for our analysis in Annex 1. We see a snapshot of all regulated mortgages every 6 months in this data. However, this is the first and only snapshot to date to include the full inactive closed book population, which is the focus of this analysis. In addition, this data does not contain the variables we require to assess whether a borrower can switch their mortgage. We therefore merge PSD007 with other datasets (PSD001 data and CRA data) to get a fuller view of a single mortgage and its borrower.

2.2 We cannot match all of the PSD007 mortgages (we explain why in the following paragraphs) and so the matched sample is smaller than the population of PSD007 mortgages. Using the matched data to make inferences about the closed book population risks us over or underestimating the true characteristics of mortgage prisoners. Below we explain the matching process. Appendix 1 provides more technical detail on both the datasets and the matching process to create the sample.

Matching process

Matching of PSD007 to PSD001

2.3 First, we match all open mortgages in PSD007 in 2021 H1[1] to those mortgages in mortgage sales data, PSD001. PSD001 has information about the mortgage at the point of origination, which is necessary for us to be able to estimate a loan to value and assess ability to switch.

2.4 We have calculated LTVs in our analysis as firms do not report the current LTV as part of regulatory reporting. To estimate LTV for each mortgage, we need the current lending balance and the current property value:

- we take the current lending balance as of 2021 H1 from PSD007
- we estimate the current property value by inflating the property value at the point of origination, which we take from PSD001. In the case of closed book mortgages, this is usually well over 10 years ago. We use the ONS House Price Index at local authority level to inflate this to the current property value
- we then estimate current LTV by calculating the current balance as of June 2021 as a percentage of the estimated current property value.

1 All closed book mortgages are reported in June 2021. However, as firms can report on their mortgages at any point in each 6-month period in PSD007 some information on other mortgages is from earlier in 2021 H1.

2.5 We are not, however, able to match all the mortgages in closed books (195,000) to their origination data in PSD001. We can only match around 145,000 of those mortgages. There are two reasons for this:

- first, PSD001 was first collected in Q2 2005. 17,000 mortgages in closed books were opened before this and therefore we do not have the origination data for these mortgages
- second, as there is not a unique identifier for each mortgage across both datasets, we match mortgages on data that should not change between origination and reporting in the last reporting period of PSD007. But if there are issues in the reporting of this data, for example, an incorrect or missing postcode or date of birth, then we cannot match the mortgage. We estimate around 33,000 mortgages are impacted by this.

2.6 We have considered the extent to which the 145,000 matched mortgages between the PSD001 and PSD007 are similar to the closed book population of 195,000 and therefore whether the characteristics of the matched data enable us to estimate accurately the characteristics of the population.

2.7 As we are unable to match mortgages initiated before 2005 (17,000 or 9% of the 195,000), our matched data has fewer years since origination than the wider population. We do not think this materially affects our analysis as the mortgages we are unable to match are not materially older than the wider closed book population: the median origination date for the 195,000 mortgages in the closed book population is November 2006 and the median origination date for the 145,000 closed book mortgages we have matched with PSD001 is January 2007. In addition, we have checked how the final matched sample differs from the closed book population and how this affects our analysis (see paragraphs 2.12 – 2.18, and Table 19 in Appendix 1 for a list of the characteristics we have compared).

2.8 Where there are inconsistencies between how mortgages are reported in PSD001 and PSD007 and thus we do not match mortgages, we would expect this to result in little bias in the sample. This is because mismatches in reporting are more likely to be random, and so there is no reason why mortgages of certain characteristics should be excluded from the sample.

Matching PSD to CRA

2.9 Second, we match these PSD007-PSD001 matched data to a 10% random sample of individuals from a credit reference agency's dataset. CRA data are important to understand the wider financial position of the borrower. Borrowers' other debt and ability to meet payments in the future is an important consideration for a prospective lender and therefore in determining borrowers' ability to switch. From the detailed financial CRA data we are able to calculate an individual's likelihood of default in the next 12 months, and related credit score.

2.10 As we are matching the PSD007-PSD001 matched data to a sample of borrowers, we would not expect to match all those closed book mortgages to the CRA data. Rather, we could only match a proportion of closed book mortgages. This is not a problem for our analysis as the CRA sample is a random sample. This means that the matched sample should be representative of the wider closed book population and therefore we can use it to make inferences about the wider closed book population.

2.11 Given a 10% sample, it might be assumed that we would match 10% of the PSD007-PSD001 matched mortgages to the CRA data. This would mean we would expect to match around 14,500 mortgages to the CRA data. Instead, we match 6,300 mortgages to the CRA data. The key reason for a lower matched sample than 10% is that not all firms report to the CRA and therefore we are unable to match the mortgages held by these firms to CRA data. Only 63% of mortgages in the closed book population are held by a firm reporting to the CRA. In addition, slight differences in the data reported to us or the CRA, or errors in records, mean that we do not get perfect matches (and hence we 'lose' those mortgages for the final sample).

Sampling implications

2.12 We have assessed the key differences between the final matched sample and the closed book population, and the corresponding implications on our estimate of mortgage prisoners. Comparing our final matched sample of 6,300 closed book mortgages to the closed book population of c.195,000, we observe that most of the characteristics of the matched sample and the closed book population are similar (see Appendix 1 for more details), except:

- the median interest rate on the matched sample (4.14%) is higher than the closed book population (3.02%)
- the proportion of interest-only mortgages in the matched sample (47%) is lower than in the closed book population (54%).

2.13 We expect these differences between the population of mortgages in closed books and the matched sample will impact our estimate of the number of mortgages held by mortgage prisoners in the following ways:

- we would likely see an overestimate of the number of mortgage prisoners based on the differences in interest rate alone. This is because we define those with interest rates above 3.35% as mortgage prisoners. If our sample has proportionally more mortgages above this rate than the population, then our estimate of the number of prisoners will be an overestimate
- we have fewer interest-only mortgages in our sample than in the closed book population. Interest-only mortgage borrowers are more likely to be prisoners (as we use an additional criterion to identify borrowers unable to switch for interest-only mortgages – see paragraph 3.5 below). Consequently, we might be underestimating the true number of prisoners with interest-only mortgages, if considering this difference alone (by a maximum of 10,000 mortgages, see Appendix 1 for a fuller discussion).

2.14 The firms in our sample cover 63% of the closed book population. In aggregate the non-matched firms do not seem to be very different from the matched firms, on the basis of the variables that we see in the PSD population, as the characteristics of the sample and population are all similar (see table 19 in Appendix 1) except for one characteristic, the median interest rate. The key difference is that we observe proportionally fewer mortgages at around 2% in the matched sample and this leads to a higher median interest rate for the matched sample. By having fewer mortgages at 2% in our sample we might be slightly overestimating the number of prisoners. This is because if we had a more representative number of mortgages at 2% in our sample, the number of prisoners would be lower (because by definition borrowers paying 2% are not mortgage prisoners).

2.15 We avoid relying on the sample when it is not necessary for us to do so. Specifically, the number of those in payment shortfall and near the end of term is taken from the full population, ie it is not an estimate from the sample. After excluding those in payment shortfall and near the end of term, we then scale our sample to the remaining mortgages in the closed book population. This scaling up means that the number of mortgages prisoners is an estimate.

2.16 In presenting our findings from the analysis of the matched sample we used a simple scaling up of our sample, rather than performing more complex adjustments (or weighting). While weighting the sample would make our sample look more like the closed book population on the variables we observe for all closed book mortgages, it risks making our sample less representative on variables we do not observe for all mortgages. We have no reason to assume the data in other unobserved cases is any different from the sample we have, so we consider the safest assumption is to assume similar characteristics absent any further information.

2.17 Where we observe differences because we are missing certain firms in the sample (in the Together mortgages analysis in section 4), we have adjusted the scaling to account for this difference.

2.18 Taking all these aspects together, using a sample to estimate the number of mortgage prisoners and then assess their characteristics does lead to some uncertainty in our estimates. However, we believe that there is benefit from matching with CRA data as we can only assess ability to switch by gaining information on the creditworthiness of borrowers. The analysis we generate is the most comprehensive we can provide, and we have a reasonable understanding of the data limitations to factor these into our conclusions. We do not think that the uncertainty means that our estimate of the number of mortgage prisoners is materially different from the true number in the population.

3 Identifying mortgage prisoners

3.1 A mortgage prisoner is defined as a borrower who is up to date with payments and:

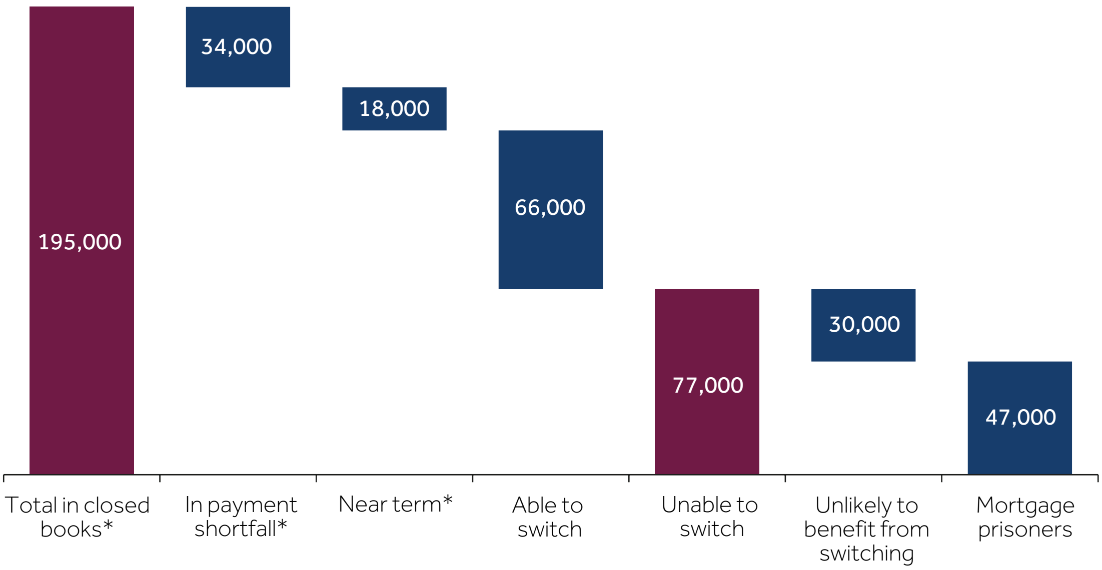
- is unable to switch to a new mortgage deal (with a new lender or with their existing lender) and
- could potentially benefit from switching depending on their loan and borrower risk characteristics.

3.2 Here we focus on identifying the number of mortgage prisoners in closed books with inactive firms.

3.3 As of 30 June 2021, there are around 195,000 mortgages in the population of closed books with inactive firms. This represents 2.3% of the total number of residential mortgages (8.5 million). We estimate that there are **47,000 mortgage prisoners** (24% of the closed book population, 1,700 in our sample).

3.4 Figure 1 shows how we arrive at our estimate of mortgage prisoners.

Figure 1: Closed book mortgages and mortgage prisoners



*These figures are taken from the analysis at Annex 1

3.5 To estimate the number of mortgage prisoners we remove the following groups of mortgages from the closed book population of 195,000 mortgages (see Appendix 2 for sensitivity tests of the assumptions we make here):

- First, **34,000** mortgages (17% of mortgages in closed books with inactive firms) who cannot switch as they are not up to date with payments (ie they are in payment shortfall in the first half of 2021)[2]. We take these away because borrowers who are not up to date with payments cannot switch to a new deal even if they have a mortgage with a lender in the active market.

2 In our Statement on mortgage prisoners (2020) last year we excluded mortgages that had not been up to date at any time in the last 12 month.

- Second, **18,000** mortgages (9%) which are near term (balance of less than £10,000 and/or a short remaining mortgage term (2 years or less remaining)). We remove these mortgages as well, because these borrowers are unlikely to be able to switch to a new deal in the active market – borrowers need a minimum balance and term to be eligible for a new deal – and are unlikely to save material amounts by switching.
- Third, we estimate that **66,000** mortgages (34%) could switch on the open market (ie they are within the credit risk appetite of active lenders). This figure is an estimate, as some borrowers may have circumstances rendering them unable to switch which we cannot see in the data (eg they have no income). To get to this estimate:
  - we assume that interest-only mortgages[3] with a loan to value (LTV) greater than 50% are unlikely to have a strategy to repay the capital and so will be unable to switch. This is a conservative assumption (as it means we might be overestimating the number of mortgage prisoners) as some lenders will lend above 50% without a repayment plan. There are a significant number of interest-only mortgages in the closed-book population, but we do not know whether a consumer has a strategy to repay the capital at the end of the mortgage term. We would expect that consumers paying relatively high interest rates would have switched and accessed better interest rates if they had a strategy to repay the capital
  - we assume that closed book borrowers cannot switch if their credit score is worse than the credit scores[4] of recent switchers in the open market. This allows us to go beyond the information relating to the mortgage alone in assessing a borrower's ability to switch. We identify a threshold credit score below which a borrower will find it hard to switch. This threshold credit score is the 5th percentile of credit scores by LTV band[5] for recent switchers (see Table 1). In our analysis borrowers with credit scores below this level are unable to switch.

Table 1: 5th percentile of credit scores by LTV bands for recent switchers

LTV band	Capital and interest	Interest-only mortgage
0% – <=30%	617	627
>30% – <=50%	617	619
>50% – <=60%	620	n/a
>60% – <=75%	616	n/a
>75% – <=85%	612	n/a
>85% – <=90%	611	n/a
>90% – <=95%	612	n/a
>95% – <=100%	629	n/a
>100%	660	n/a
Unknown LTV	615	616

Notes: We do not report the 5th percentile for interest-only mortgages with an LTV above 50% as these mortgages are defined as being unable to switch (see Appendix 2 to see how changing the 5th percentile assumption affects the number of prisoners). Where we were unable to calculate a current LTV or where we do not observe recent switchers in an LTV band, the 5th percentile of the whole cohort of recent switchers was used (capital and interest – 615, interest-only – 616)

3 In our analysis, we include part and part repayment mortgages within the interest-only numbers.

4 We have calculated these credit scores for borrowers. See Appendix 1 for explanation of the calculation of this credit score.

5 The 5th percentile was selected instead of, for example, the lowest score, to reduce the influence of outliers on the analysis. We note that there is no clear trend in the credit scores from the smallest to the highest LTV band. To calculate the 5th percentile, we order switchers by credit score and find the score which is higher than the lowest 5% of credit scores.

- Based on these criteria we estimate the remaining **77,000** mortgages (40%) are unable to switch. Borrowers that cannot switch pay 3.47% on average.
- Fourth, we estimate that **30,000** mortgages of those who are unable to switch are not mortgage prisoners under our definition as they pay relatively low rates of interest and so may not benefit from switching. We assume that a borrower may benefit from switching if the interest rate is above a current rate of 3.35%: this is the lowest standard variable rate (SVR) in the mainstream market at the time of this analysis (September 2021, Moneyfacts). We use it as an illustrative rate to estimate the number of mortgage prisoners.

3.6 This gives an estimate of **47,000** mortgages that meet our definition of a **mortgage prisoner** (as they currently pay more than 3.35%). They pay 4.32% on average. These borrowers cannot switch even though they are up to date with payments but are paying a higher rate and would be likely to benefit from switching.

3.7 The illustrative rate we have used to estimate the number of mortgage prisoners is not intended as a judgement as to what constitutes a fair and appropriate interest rate for borrowers who cannot switch in the open market. It is simply a way of bringing attention to the importance of considering risk-based pricing when considering whether a borrower is likely to benefit from switching because, by definition, a mortgage prisoner is not eligible for any mortgage deal available in the market. This is consistent with the method used in our Mortgage Market Study in 2018, which used the lowest standard variable rate offered in the market at that time in the period of analysis.

3.8 The illustrative rate is reasonable as it is below the average introductory rate for non-prime borrowers (3.60%) but above the average prime introductory rate (2.37%) in September 2021 (Moneyfacts). Changing the illustrative rate has a relatively small effect on the estimate of mortgage prisoners (see paragraph 3.11).

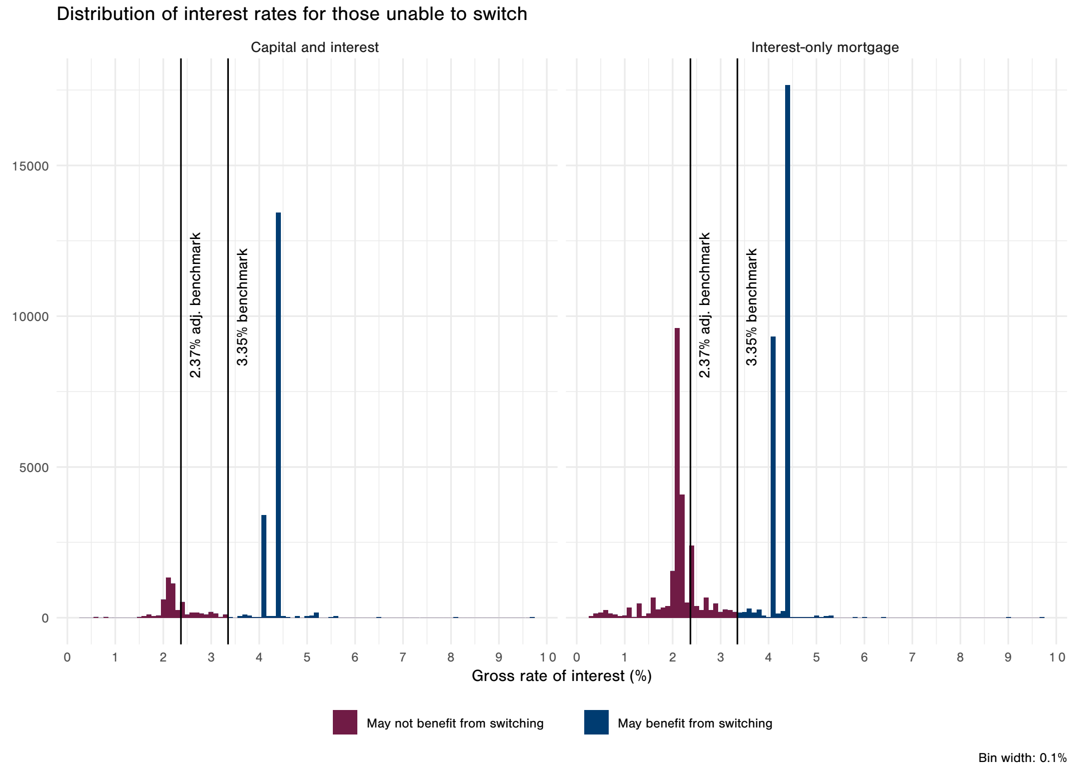
3.9 The number of mortgage prisoners is not particularly sensitive to changes in any of the other assumptions above (see Appendix 2). This gives us further confidence in our estimate.

Interest rates

Distribution and sensitivity to the 3.35% illustrative rate

3.10 The chart below displays the distribution of interest rates for those we determine are up to date with payments, not near term but are unable to switch (77,000 borrowers). The illustrative rate used to assess whether switching would be beneficial (SVR 3.35%) is marked. (For the distribution of interest rates paid by the 195,000 closed book borrowers see Annex 1.)

Figure 2: Distribution of interest rate for the 77,000 borrowers unable to switch



3.11 The number of mortgage prisoners is not particularly sensitive to this assumption, as we observe two peaks in the distribution of interest rates paid in June 2021 by borrowers with closed book mortgages that are unable to switch (one around 2.1% and another between 4% and 4.5%). We could use two alternative benchmark rates of 2.37% and 3.6% to estimate the number of mortgage prisoners (see paragraph 3.5). Using the 2.37% alternative benchmark would result in an estimate of 54,000 mortgage prisoners (ie an extra 7,000 that are mainly interest-only mortgages). Using the 3.6% benchmark would result in an estimate of 46,000 mortgage prisoners (ie a reduction of 1,000).

Interest rate differential

3.12 The 77,000 unable to switch (who may or may not benefit from switching) pay 3.47% on average (ie on average 0.12 percentage points more in interest rate than the 3.35% SVR).

3.13 By comparison, the mean interest rate for those up to date with payments and able to switch (66,000 mortgages) is 3.66% (see Table 2 for the distribution). These borrowers have different creditworthiness characteristics to mortgage prisoners. 13,000 of the 66,000 (20%) able to switch have an interest-only mortgage, compared with 54,000 (70%) in the unable to switch group.

3.14 Mortgage prisoners pay a 4.32% interest rate on average (ie 0.97 percentage points more than the 3.35% SVR) and typically between 4.14% and 4.38%.

3.15 As a mortgage prisoner is defined as paying an interest rate of more than 3.35%, this results in the higher interest rates we observe for mortgage prisoners compared to the other groups in Table 2. We note that the interest rates for those able to switch are, on average, slightly higher than for those unable to switch. Given the length of time since these mortgage contracts were written, we would not expect the current interest rates paid to reflect the current credit risk of borrowers.

Table 2: Distribution of interest rates

	1st Qu.	Median	Mean	3rd Qu.
Unable to switch	2.20	4.14	3.47	4.38
Mortgage prisoners	*4.14*	*4.28*	*4.32*	*4.38*
Able to switch	2.40	4.14	3.66	4.38

3.16 Additionally, we have estimated an alternative difference using the mean reversion rate[6] (the rate a mortgage reverts to at the end of any incentive or fixed rate period) of inactive borrowers in active books, ie those who have a mortgage with an active lender but have not switched for at least 5 years. The mean reversion rate for inactive borrowers is 3.01%. Given that the mean interest rate for the closed book population who are unable to switch is 3.47%, and 4.32% for mortgage prisoners, those in the closed book population who are unable to switch pay on average 0.46 percentage points more than inactive borrowers; and mortgage prisoners pay 1.31 percentage points more. We note that inactive borrowers may not be directly comparable in terms of their credit worthiness.

3.17 89% of mortgage prisoners currently pay an interest rate that is lower than at origination. On average, mortgage prisoners pay 1.6 percentage points less now than at origination. This means they are making lower monthly payments than they did at origination. For the closed book population, borrowers pay 2.54 percentage points less now than they did at origination.

6 We identify these mortgages in PSD007 by excluding mortgages that are currently on an incentivised rate.

4 Our findings

Analysis of mortgage prisoners

4.1 The following analysis focusses on the mortgage and borrower characteristics of the 47,000 we estimate are mortgage prisoners. They are set out here to enable stakeholders to better understand this group of mortgages and borrowers. The characteristics are based on our sample, which includes 6,300 closed book mortgages (see Appendix 1 for more detail on the sample).

4.2 Within the group of mortgage prisoners, it is worth considering interest-only separately from capital and interest repayment mortgages as repayment mortgages tend to have a lower LTV.

4.3 We find that 62% of mortgage prisoners have an interest-only mortgage. We see more prisoners with interest-only mortgages because borrowers of interest-only mortgages are defined as mortgage prisoners if they have an LTV greater than 50% and most interest-only borrowers (70,000)[7] in the 195,000 closed books population have an LTV greater than 50%.

Table 3: Repayment type of mortgage prisoners

Repayment type	Percentage	Number of mortgages
Capital and interest	38	18,000
Interest-only mortgage	62	29,000

4.4 The table below summarises the key characteristics of mortgage prisoners on average (median) and for the upper and lower quartile[8].

Table 4*

	Capital and interest (median)	Interest-only (median)
LTV	51% [37%, 59%]	67% [59%, 77%]
Balance	£66,000 [£47,000, £89,000]	£127,000 [£97,000, £171,000]
Remaining term	15 yrs [10 yrs, 20 yrs]	10 yrs [8 yrs, 14 yrs]
Monthly repayment	£535 [£420, £714]	£472 [£366, £629]
Equity	£67,000 [£45,000, £105,000]	£59,000 [£33,000, £108,000]
Age	45 [40, 51]	50 [43, 55]
Unsecured debt	£12,000 [£5,000, £24,000]	£11,000 [£3,000, £28,000]

*Lower and upper quartile figures, respectively, are shown in brackets.

4.5 These characteristics are discussed in more detail in the following sections.

7 This includes those in shortfall and near term

8 This table and following tables contain 1st and 3rd quartile to provide an indication of range of the characteristics described. The 1st quartile is the number for which 25% of the data is below. Likewise, the 3rd quartile is the number for which 75% of the data is below.

Mortgage characteristics

Loan to value

4.6 Loan to value (LTV) on a mortgage is a key variable in determining whether a mortgage borrower is able to switch to another mortgage. The higher the LTV the less likely a mortgage borrower will be able to switch and, if they can switch, the rate of interest rate they will be able to obtain will usually be higher.

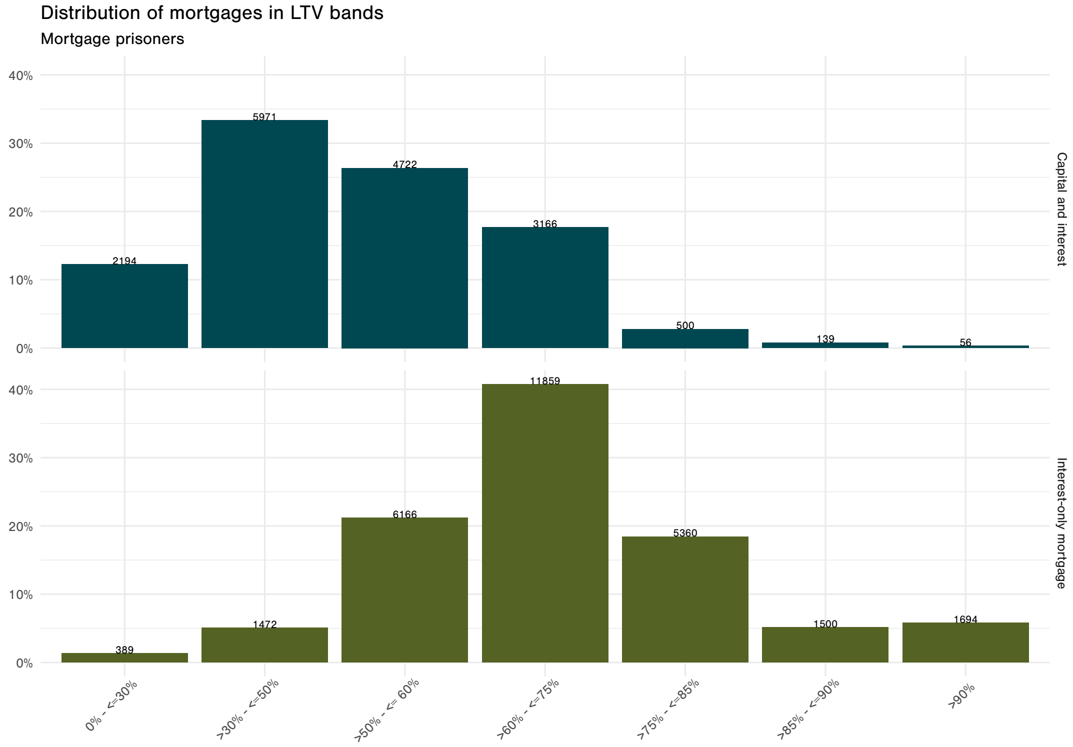
4.7 On average, prisoners with capital and interest repayment mortgages have a median LTV of 51%, and a mean of 49%, which, on its own, would not prevent these borrowers from switching in the open market. As LTV alone will not prevent these borrowers from switching, the reason they are unable to switch must be their creditworthiness. Hence, in identifying prisoners for capital and interest repayment mortgages we do not use LTV but focus on their credit scores.

4.8 In contrast, those prisoners with interest-only mortgages may either be prevented from switching in the active market as they are a poor credit risk or because they have no strategy to repay the capital borrowed at the end of the mortgage term and have an LTV above 50%. This is because most lenders will not lend above 50% LTV on interest-only mortgages if the borrower has no credible strategy to repay the capital (September 2021, Moneyfacts). Most prisoners with interest-only mortgages have an LTV above 50% (with the median LTV at 67% and mean of 68%). As shown in the chart below, there are around 6,000 mortgages that are relatively close to this 50% threshold, ie between 50% and 60%. These borrowers may be able to switch if house prices increase further, if they repaid some capital, or if lenders flexed their criteria.

Table 5

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	37	51	49	59
Interest-only mortgage	59	67	68	77

Figure 3: Loan to value (LTV)

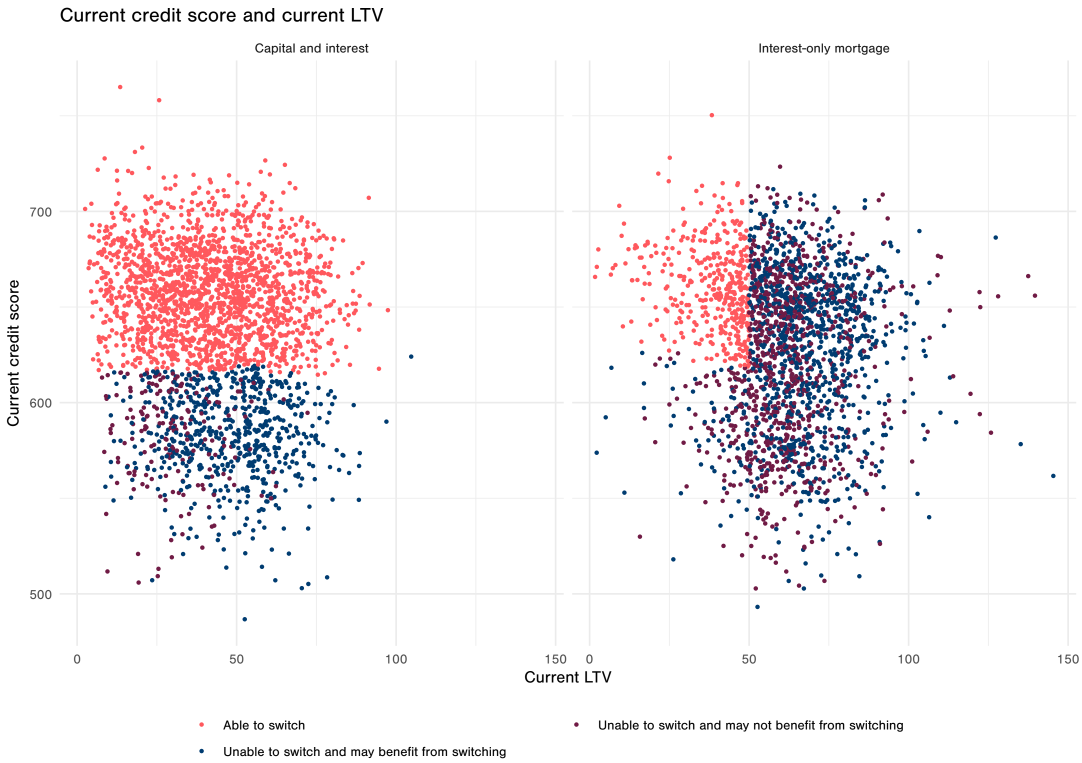


4.9 Negative equity further reduces the options for such borrowers, as selling the property would not cover the outstanding balance on the mortgage. In our closed book analysis at Annex 1, we found that fewer than 300 mortgages in the entire closed book population have negative equity, so very few mortgage prisoners are in negative equity.

Credit score

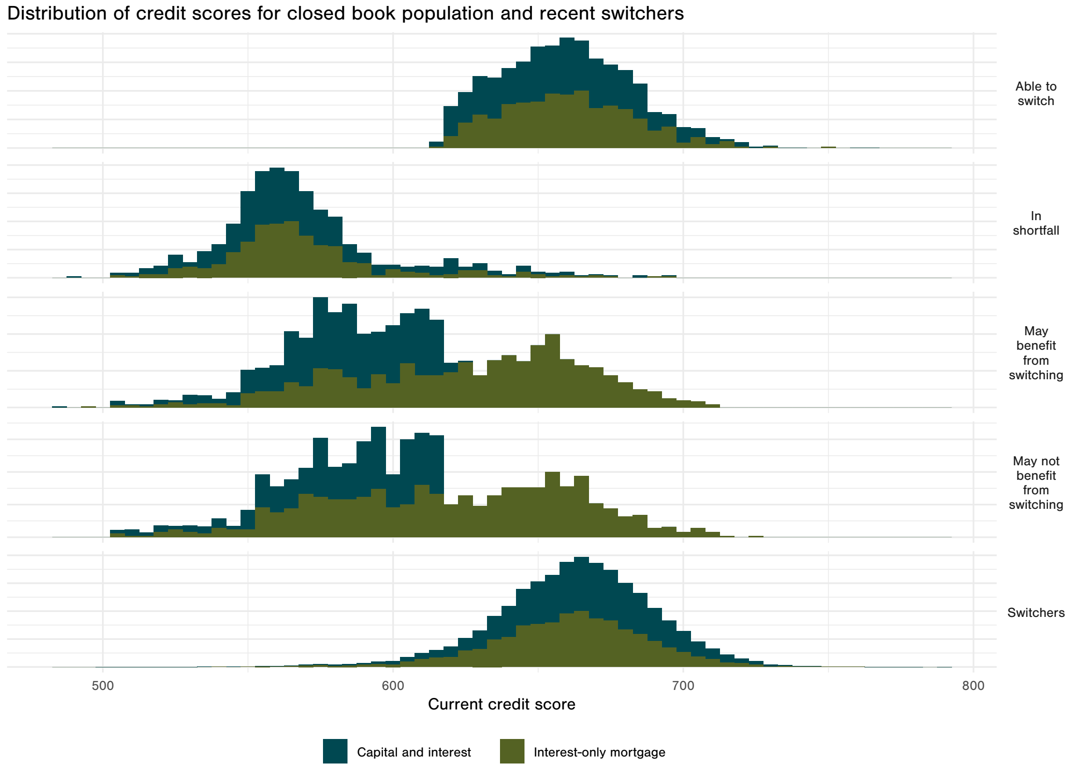
4.10 Figure 4 shows whether borrowers can or cannot switch by showing the relationship between LTV and a calculated credit score. For borrowers with capital and interest repayment mortgages, we categorise mortgages with a credit score above the 5th percentile of credit scores within each LTV band of recent switchers as able to switch (coloured pink in Figure 4) (see Table 1). Those below this threshold are unable to switch. For those with interest-only mortgages we also show the effect of the assumption that borrowers with an interest-only mortgage above 50% are unable to switch. Those able to switch have credit scores above the 5th percentile of credit scores of recent switchers and an LTV below 50%.

Figure 4: Credit score and current LTV of mortgages in closed books



4.11 Figure 5 shows the distribution of credit scores for the different borrower groups in the closed book population compared to recent (external) switchers in the mortgage market (the group at the bottom of the chart). We observe that those in payment shortfall (who are therefore unable to switch) have significantly worse credit scores than recent switchers. Except for those able to switch, borrowers in the closed book population have significantly lower credit scores than those of switchers in the active market. The credit scores distribution for the 'may not benefit from switching' (which is largely below that of recent switchers) emphasises why they would be unlikely to be able to access a prime deal and supports using a higher rate than 2.37% (average prime introductory rate in September 2021, Moneyfacts) to identify those who would benefit from switching among those unable to switch.

Figure 5



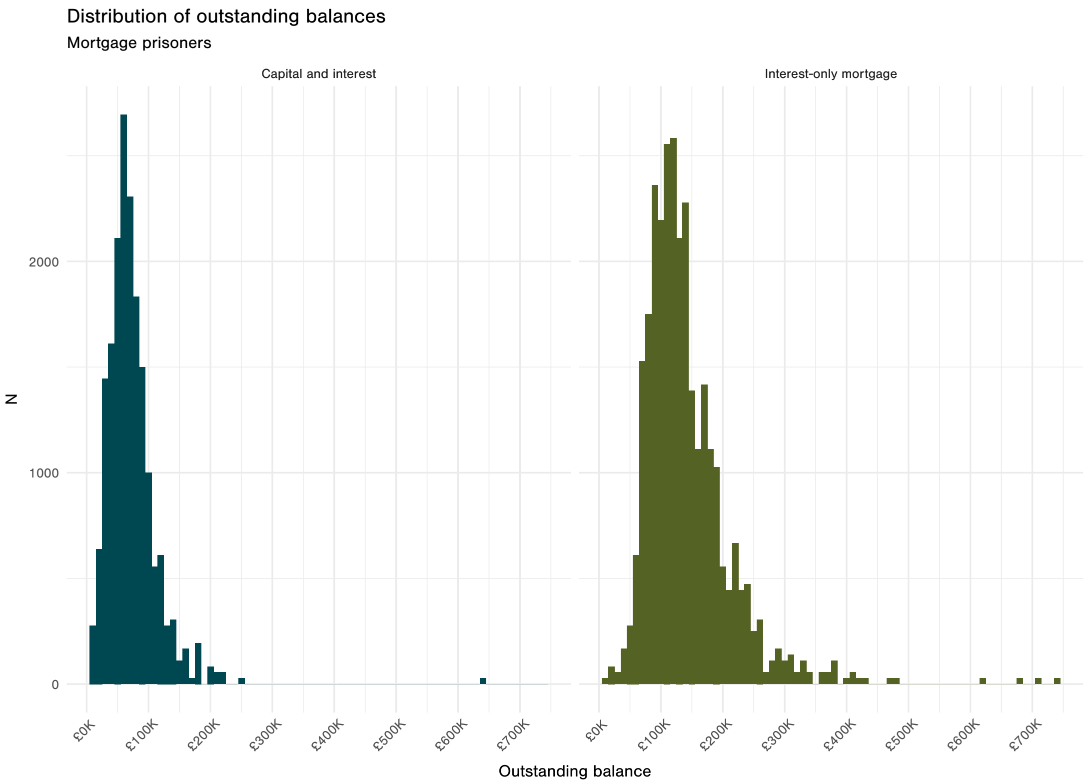
Outstanding balance

4.12 The total outstanding balance on prisoners' mortgages is around £5.5bn. The median balance for mortgage prisoners with capital and interest mortgages is £65,700 while for interest-only borrowers the median balance is almost double at £127,000. Outstanding balances are relatively tightly distributed around the median. We can see in the figure below that those with capital and interest repayment mortgages have much lower outstanding balances. For capital and interest repayment mortgages, the vast majority of outstanding balances are less than £100,000, whereas most interest-only mortgages have balances of more than £100,000.

Table 6: Outstanding balance summary statistics

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	47,400	65,700	72,300	88,700
Interest-only mortgage	97,100	127,000	142,000	171,000

Figure 6



Remaining term

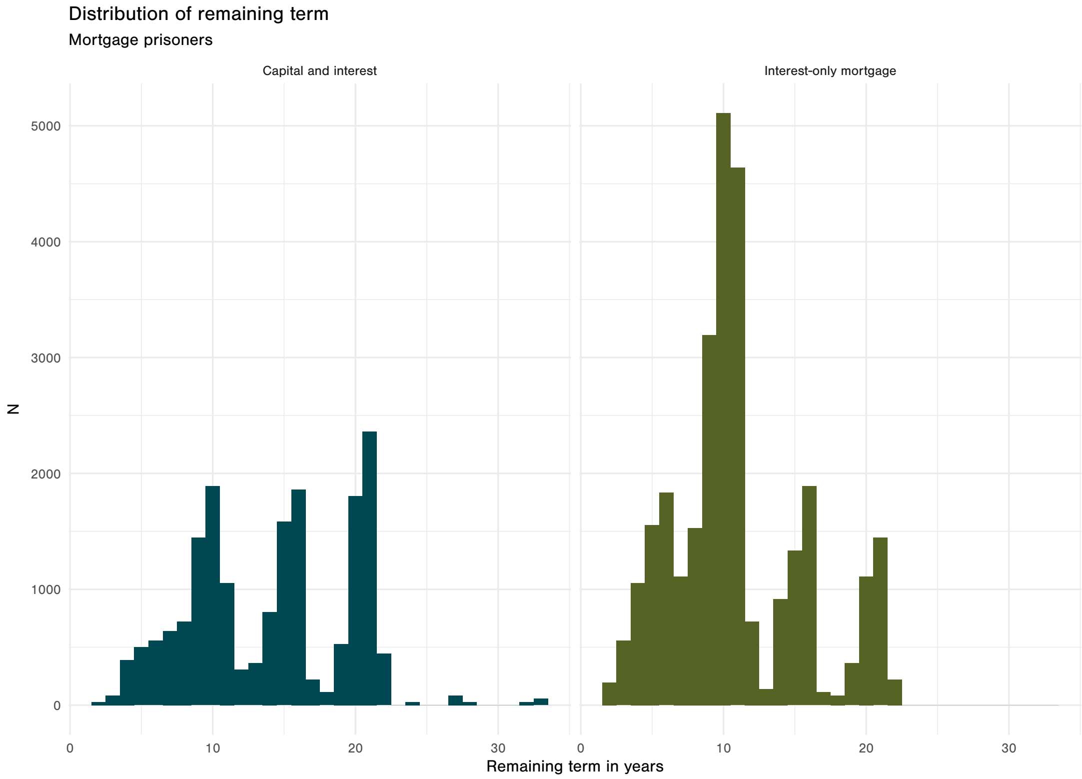
4.13 The median remaining term for mortgage prisoners is more than 10 years (10 years for interest-only mortgages and 15 years for repayment mortgages). There are some mortgages in these books that have a significant (over 20 years) remaining term.

4.14 The most common mortgage terms for mortgage prisoners are 25, 30 and 35 years. The peaks around 10, 15 and 20 years in Figure 7 reflect that 97% of mortgage prisoners have mortgages that originated between 2005 and 2007 and therefore are between 14 and 16 years into the mortgage term. Those that had a 25-year term have around 10 years left, those with 30-year terms have 15 years left and those with 35-year terms still have 20 years remaining on their mortgage. It is mainly capital and interest repayment mortgages that have these very long terms remaining.

Table 7: Remaining term (in years) summary statistics

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	10	15	14	20
Interest-only mortgage	8	10	11	14

Figure 7



Monthly repayments

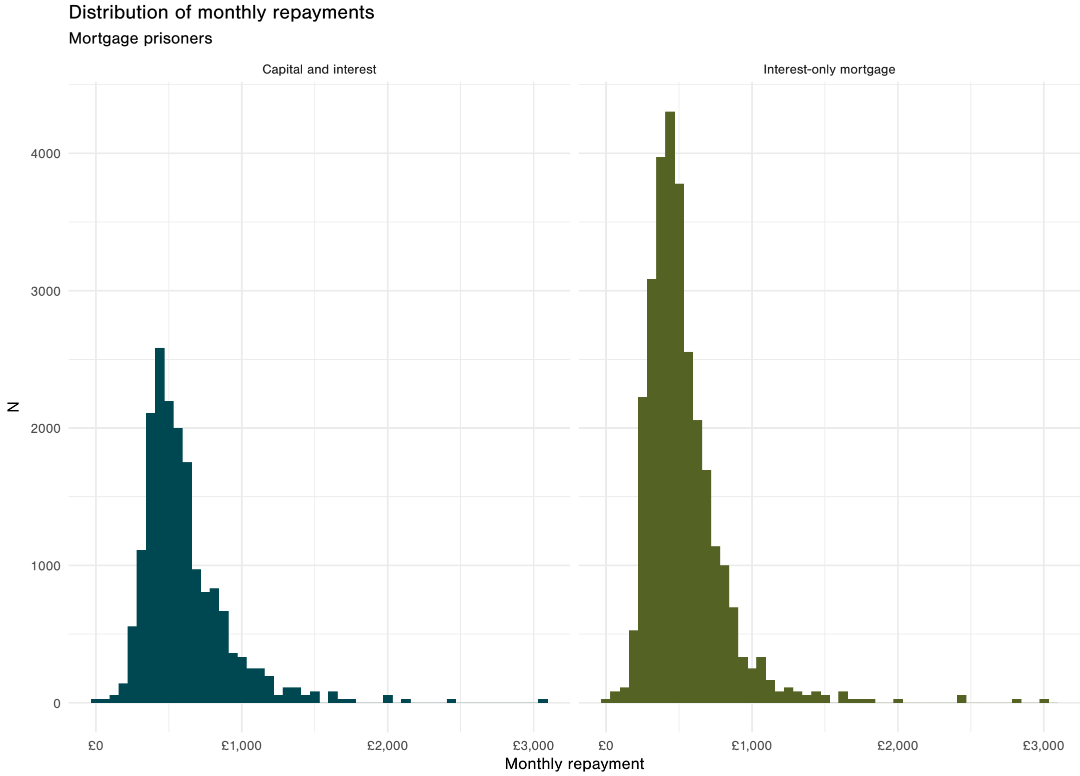
4.15 The chart below shows the distribution of expected monthly payments. The median expected monthly payment is around £500 for both capital and interest repayment and interest-only prisoners. Monthly repayments appear relatively tightly distributed around the median. Very few borrowers have monthly payments of over £1,000.

4.16 Mortgage prisoners with interest-only mortgages have a median monthly repayment of £472. Capital and interest repayment borrowers have a median monthly repayment of £535.

Table 8: Monthly repayment (£) summary statistics

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	420	535	606	714
Interest-only mortgage	366	472	531	629

Figure 8



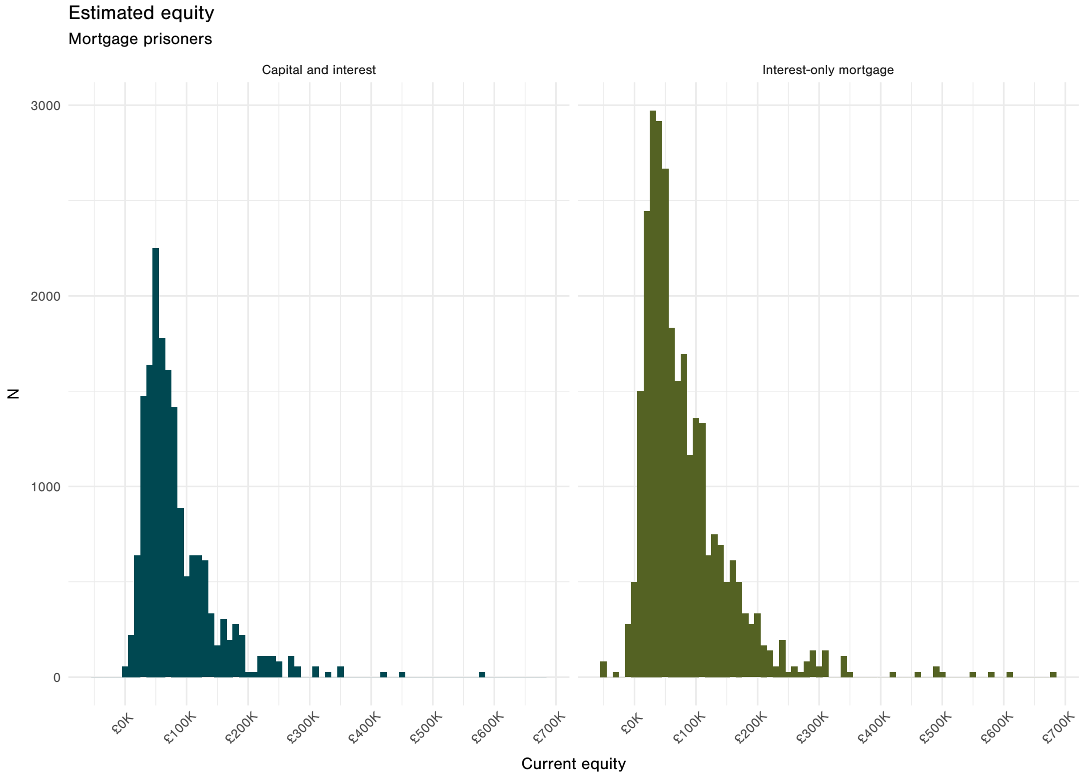
Equity

4.17 We estimate that the average prisoner with a capital and interest repayment mortgage has slightly more equity than the average interest-only mortgage prisoner. By equity we mean the amount remaining after subtracting the mortgage balance from our estimate of the current property value. Those mortgage prisoners with interest-only mortgages typically have similar levels of equity to capital and interest repayment mortgages even though they have much higher outstanding balances. This is because they have higher value properties compared to those with capital and interest mortgages.

Table 9: Equity (£) summary statistics

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	45,421	66,986	84,522	105,735
Interest-only mortgage	32,766	59,359	80,953	107,544

Figure 9: Equity



4.18 Mortgage prisoners with an interest-only mortgage typically do not meet lender criteria to enable them to switch on a like for like product in the open market. For those mortgage prisoners above 50% LTV, the median amount required to reduce the balance below 50% LTV is £32,000. Nearly all (28,000) of the interest-only mortgage prisoners have an LTV above 50%.

Regional analysis

4.19 Using the postcode of the property, we can identify which region mortgage prisoners are located in. We find that almost half of mortgage prisoners are in the North of England and Scotland (North West, Yorkshire and The Humber, Scotland and North East). This compares to almost a third of all active book borrowers in the same regions.

Table 10: Number of mortgages prisoners by location

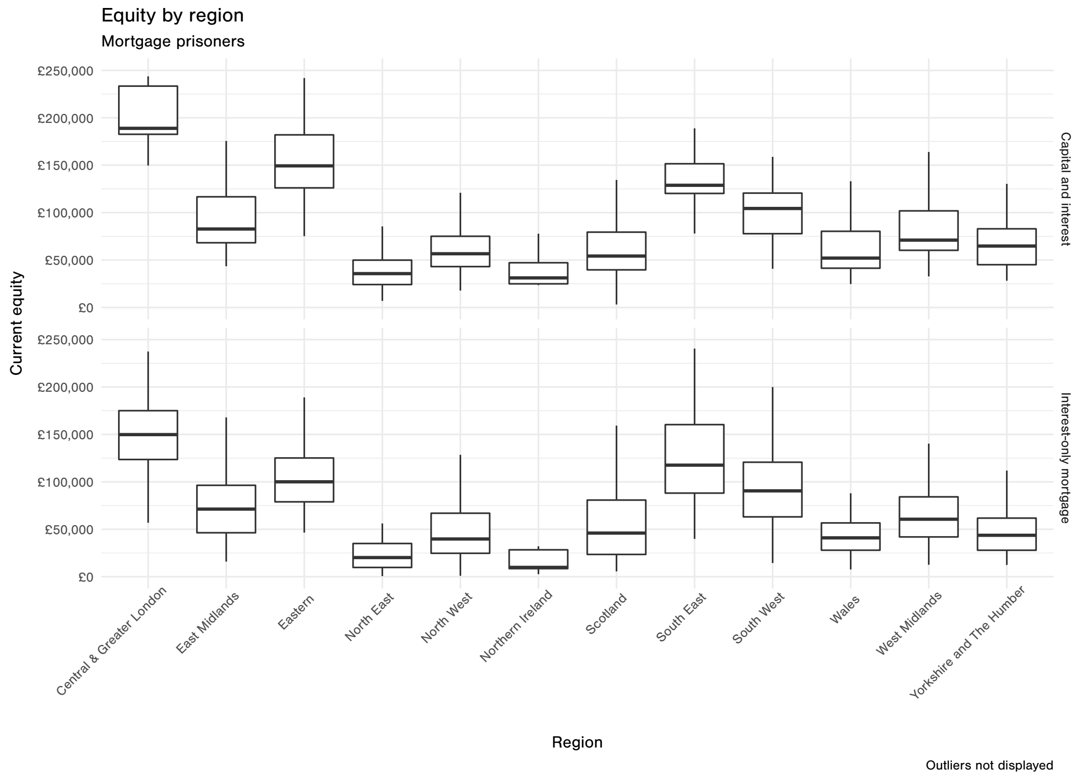
Region	Mortgage prisoners, no.*	All active book mortgage borrowers, no.
North West	7,900	829,000
Yorkshire and The Humber	5,700	620,000
Scotland	5,500	644,000
North East	4,100	290,000
South West	4,000	880,000
West Midlands	4,000	608,000
East Midlands	3,800	567,000
Eastern	3,200	692,000
Wales	3,200	300,000
South East	3,100	716,000
Central & Greater London	1,900	875,000
Northern Ireland	440	193,000

*Totals do not sum to 47,000 up due to rounding

4.20 Figure 10 plots the summary statistics for estimated equity by region. We show this because property values vary quite significantly between different regions (and over time between regions). The boxes show the bounds of the middle 50%, or interquartile (between the 1st and 3rd quartile) range of mortgage prisoners in a region. The line through this box is the median amount of equity.

4.21 The equity position of mortgage prisoners displays a clear regional effect. Both interest-only and capital and interest repayment borrowers in London and the South East of England have higher median equity than other regions. Borrowers in the North of England and Northern Ireland have noticeably lower equity positions than other regions.

Figure 10: Equity by region, £



Borrower characteristics

4.22 In this section, we look at the characteristics of mortgage prisoners, rather than the characteristics of the mortgage they hold: age, income, vulnerability (by reference to the Index of Multiple Deprivation), credit impairment at origination, arrears and payment shortfall histories, non-mortgage (unsecured debt) and Together mortgages. Where mortgages have multiple holders, we have only considered the characteristics of the first borrower as identified in PSD007.

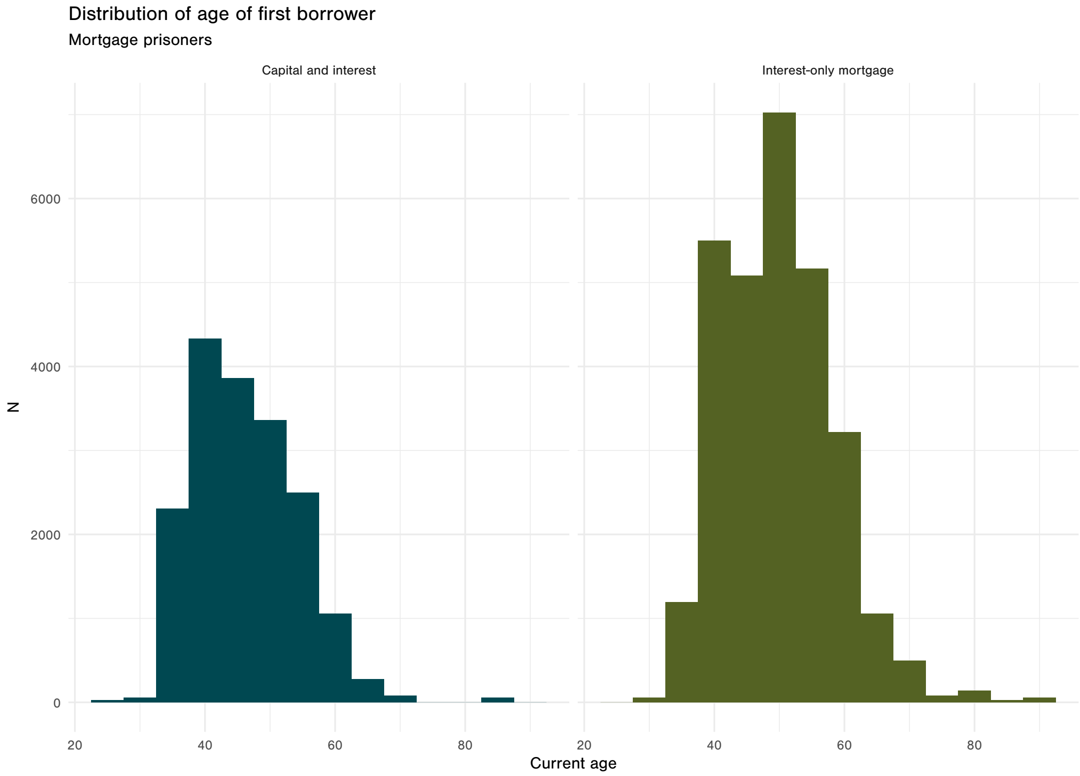
Age

4.23 Mortgage prisoners who have capital and interest repayment mortgages are on average younger than mortgage prisoners who have interest-only mortgages.

Table 11: Age of first borrower summary statistics

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	40	45	46	51
Interest-only mortgage	43	50	50	55

Figure 11



Income

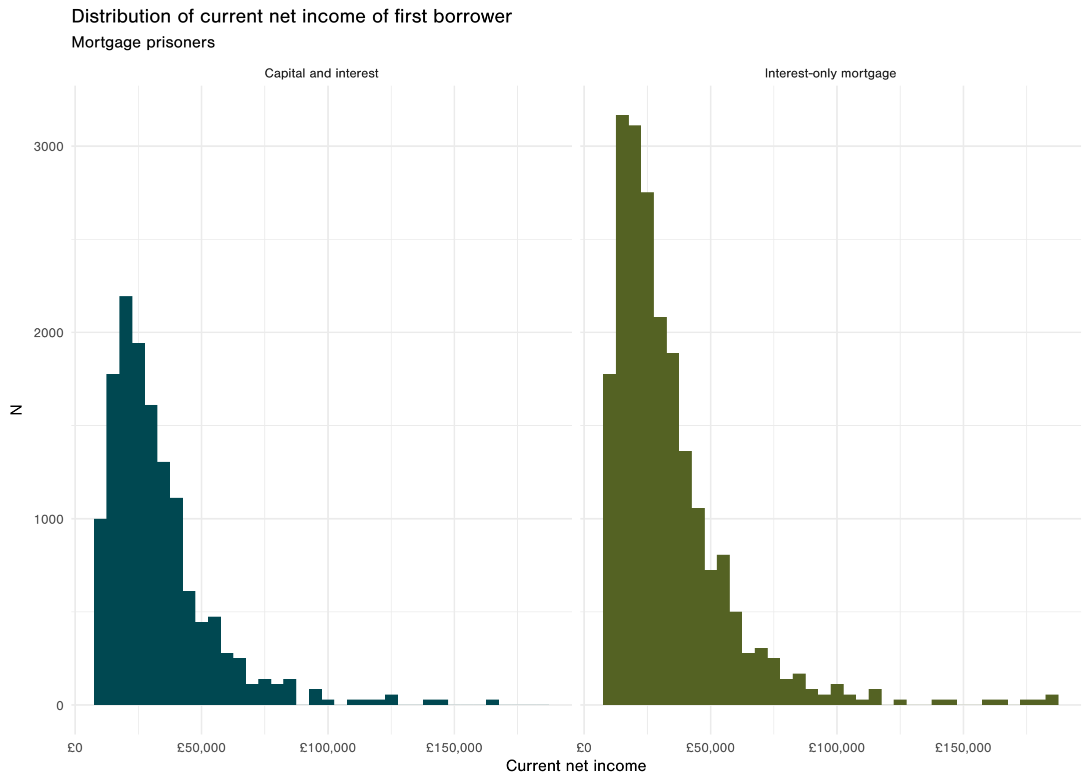
4.24 Income is estimated using CRA current account turnover data (median turnover multiplied by 12). This represents an approximation of net income, as we usually do not observe tax or other deductions in the current account balance. As the income data is on current account turnover and net of taxes, it is hard to compare to other data sources on consumers' income. However, in financial year ending (FYE) 2020, the period leading up to the implementation of measures against the coronavirus pandemic, ONS average household disposable income (after taxes and benefits) was £29,900. This is close to our estimates in Table 12.

4.25 It is noticeable that borrowers on interest-only mortgages have similar income levels to those on capital and interest repayment mortgages. We noted earlier that the distributions of monthly payments of the two groups are also similar. This implies that these borrower groups are paying a similar proportion of their income in monthly payments, irrespective of whether they have capital and interest repayment or interest-only mortgages. This may be because those with interest-only mortgages took out mortgages that maximised the amount borrowed with affordable monthly payments (as they could borrow more than on a capital and interest basis), but without necessarily considering how the balance would be repaid.

Table 12: Income of first borrower summary statistics

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	19,200	27,500	32,900	39,400
Interest-only mortgage	18,000	26,900	33,500	41,000

Figure 12



Vulnerability

4.26 The Index of Multiple Deprivation (IMD) measures the relative levels of deprivation in each local authority area. While it does not tell us whether a particular borrower is deprived, it does show the extent to which borrowers are living in deprived areas. This would be an indicator of whether mortgage prisoners are potentially more vulnerable to harm than a random selection of the UK population. Due to small numbers for Scotland, Wales and Northern Ireland in the sample, this analysis considers only England.

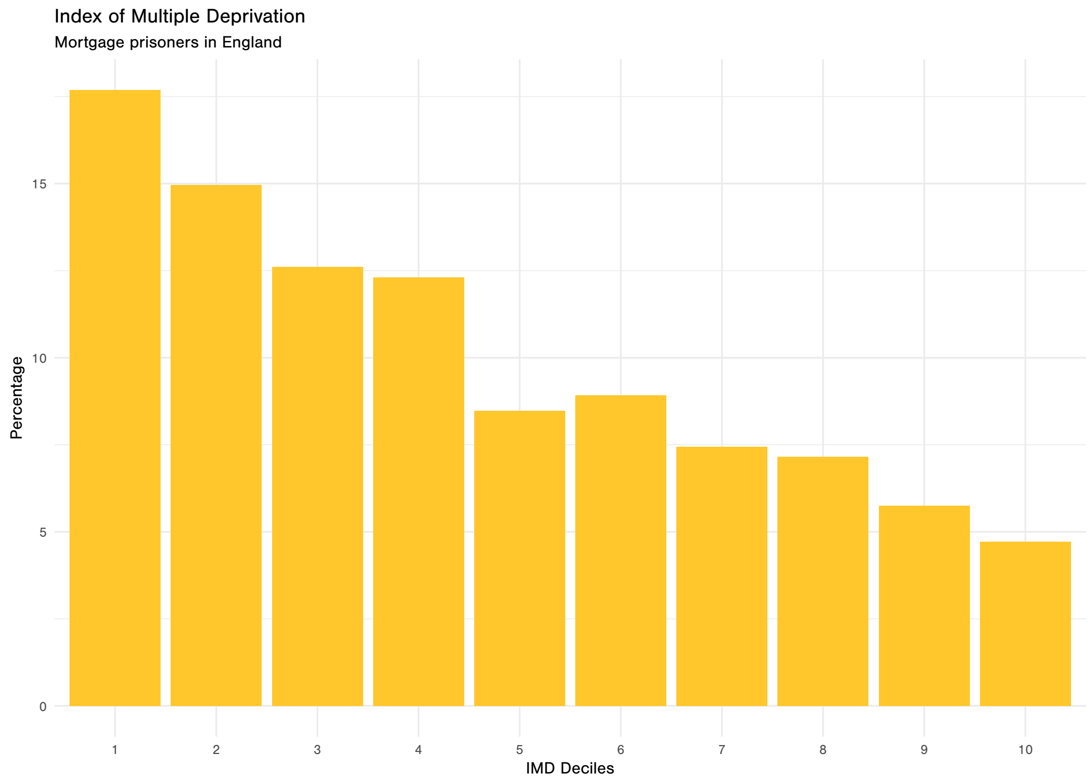
4.27 The IMD is calculated across 7 domains of deprivation: Income, Employment, Education, Health, Crime, Barriers to Housing & Services and Living environment. It ranks 32,844 Lower-layer Super Output Areas in England, with the 1st ranked area being the most deprived and the last being the least deprived.

4.28 The domains of deprivation used to calculate the IMD have some overlap with the Health and Capability drivers of vulnerability identified in our guidance FG21/1.

4.29 The 32,844 areas are split into 10 equally sized groups (deciles) by deprivation rank. Using this, we can identify the relative deprivation of the areas where the mortgage prisoners are located.

4.30 18% of mortgage prisoners are located within the first decile, ie the most deprived areas in England. 58% of mortgage prisoners are in areas within the first four most deprived deciles. Hence, mortgage prisoners are more likely to live within deprived areas than the general population.

Figure 13



Credit impairment at origination

4.31 Credit impairment is defined as having any of the following at origination:

- County Court Judgement (CCJ)
- Arrears
- Individual Voluntary Arrangement (IVA)
- Bankruptcy
- Debt relief order

4.32 Credit impairment crosses over with the over-indebtedness characteristics of the resilience driver of vulnerability in FG 21/1.

4.33 We find that 8% of mortgage prisoners with capital and interest repayment mortgages were credit impaired at origination. 6% of mortgage prisoners with interest-only mortgages were impaired at origination.

4.34 In contrast, active book mortgages have an overall rate of 0.8% credit impaired at origination. This implies that mortgage prisoners are slightly higher risk borrowers compared to the active book population. As lender risk appetite has changed since the financial crisis, we would expect that higher risk borrowers would be more likely to be unable to switch.

Table 13: Percentage of mortgage prisoners with impaired credit at origination

	Capital and interest (%)	Interest-only mortgage (%)
Impaired credit	8	6
Not impaired credit	92	94

Arrears and payment shortfall histories

4.35 We also investigated the arrears and payment shortfall histories of borrowers in the sample of mortgage prisoners against borrowers in the closed book population, and borrowers in the wider mortgage population.

4.36 To do this, we matched information in the 2021 H1 snapshot of PSD007 with previous half-year snapshots all the way back to 2015 H1. We then count how many borrowers have experienced at least one instance of payment shortfall or arrears (ie the amount of payment shortfall is equivalent to at least two monthly payments).

4.37 These figures are only for mortgages we are able to match, so they exclude unregulated entities prior to 2021 H1, as mortgages held by unregulated entities have been required to be reported for the first time in 2021 H1. Therefore, this analysis was based only on the closed book mortgages held by regulated firms that were reported in 2021 H1 and previous reporting periods. This is the vast majority of closed book mortgages, as only a small proportion (we estimate less than 4%) of our closed books population were newly reported in 2021 H1, but inconsistent reporting of these mortgages and data quality issues means that there are gaps in the historical data, with some firms not reporting at all in some reporting periods.

4.38 Among mortgage prisoners, we find that 35% have had a shortfall at some point since 2015 H1, and 16% have been in arrears.

4.39 In the closed book population of mortgages with inactive lenders, 39% borrowers have had a shortfall at some point between 2015 H1 and now, and 24% have been in arrears. The equivalent figures for the whole stock of mortgages in PSD007 are 5.7% and 2.4% for shortfalls and arrears, respectively.

4.40 Mortgage prisoners have lower levels of shortfall than the wider closed book, as mortgages with current payment shortfall are not in the mortgage prisoner group by definition.

4.41 The analysis shows that even though mortgage prisoners are currently up to date with their mortgage payments, many of them will have experienced past payment problems. We observe that mortgage prisoners are much more likely to have been in payment shortfall than the wider population of mortgage borrowers.

4.42 We cannot say whether the arrears we observe are caused by the rates that some mortgage prisoners pay. Higher interest rates (and higher payments) will mean consumers find it harder to repay their mortgage but higher risk borrowers are more likely to be charged higher rates. It is not possible to disentangle these two effects.

4.43 The interest rates mortgage prisoners pay have fallen since origination (as a result of reductions in base rates) and so monthly payments will have fallen too (see Annex 1 for more information on interest rates at origination). Given monthly payments will have fallen since origination, we expect other life events are most likely to have caused affordability problems for these borrowers since 2015 H1. We therefore do not think it is likely that the level of interest rates is the primary cause of borrowers entering arrears.

Non-mortgage (unsecured) debt

4.44 Using the CRA data, we can calculate the mean total debt of mortgage prisoners for the last 3 months of 2020. We remove the mortgage balance for their closed book mortgage as of December 2020 to approximate the debt position of each borrower in the sample.

4.45 For both interest-only and capital and interest repayment mortgage prisoners we observe a median total debt excluding the closed book mortgage of around £11,000.

Table 14: Summary of non-mortgage debt – all mortgage prisoners

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	4,900	11,600	20,600	23,600
Interest-only mortgage	2,800	11,100	35,500	28,000

4.46 Comparing this to non-mortgage debt of active book borrowers shows that the median mortgage prisoner has a higher debt than the median active book borrower. As with the analysis in the previous table, the mean debt is heavily influenced by outlier non- mortgage debts.

Table 15: Summary of non-mortgage debt – all active book mortgages

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	800	3,800	22,400	16,700
Interest-only mortgage	500	4,700	72,000	32,500

Together mortgages

4.47 For some borrowers unsecured debt is linked to the mortgage (Together mortgages[9]). We look at this debt separately because the unsecured element of a Together mortgage may be an additional barrier to a borrower switching their mortgage, as, were the mortgage element of a Together mortgage to be switched, the interest rate of the unsecured element would increase under the terms of the mortgage.

4.48 We estimate from our sample that 15,000 mortgage prisoners have Together mortgages. This is around 30% of all mortgage prisoners. 8,000 have interest-only mortgages and 7,000 have capital and interest repayment mortgages.

4.49 Table 16 shows the outstanding balance for the unsecured element of Together mortgages. The median outstanding balance (or debt) of the unsecured element of the Together mortgage is £7,200 for all mortgage prisoners with Together mortgages. Interest-only borrowers have a median outstanding balance of £6,900 and capital and interest repayment borrowers have a median of £7,500 outstanding balance.

Table 16: Summary of Together loan debt for prisoners with Together mortgages

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	4,400	7,500	9,800	13,400
Interest-only mortgage	3,500	6,900	9,000	12,800

9 Together mortgages were mortgages offered by Northern Rock with lending up to 125% LTV, with the unsecured element provided as a linked personal loan, and one interest rate across the combined product. Together mortgages are not identified in PSD data so the figures quoted are our estimates.

4.50 Mortgage prisoners with Together mortgages have much higher levels of unsecured debt compared to other mortgage prisoners. Table 17 shows the unsecured debt of Together mortgage holders. Those with capital and interest repayment mortgage have a median debt of £15,000 while those with interest-only mortgages have unsecured debts of £16,900.

Table 17: Summary of non-mortgage debt for mortgage prisoners with Together mortgages

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	8,700	15,000	22,600	26,900
Interest-only mortgage	8,200	16,900	31,800	31,900

Segmentation

4.51 In this section we segment mortgage prisoners by various characteristics. This may help identify the numbers of borrowers close to the thresholds for products that may currently be offered by lenders (and therefore more likely to be able to switch), or aid the development of new products that may be aimed at mortgage prisoners. Segmentation of the closed book population can be found at Annex 1.

4.52 We note that the segmentation, like the rest of the analysis of mortgage prisoner characteristics, is based on our sample. In the charts that follow we have therefore scaled our sample to provide estimates of the size of different segments of borrowers within the mortgage prisoner population. Where the number of mortgages in a segment is small, there is more uncertainty around the estimates.

4.53 We present two approaches to this segmentation. The first looks at the credit scores of mortgage prisoners to assess how many would potentially benefit if lenders were able to adjust any assessments of creditworthiness in assessing applications to switch or if borrowers improved their credit position. The second looks at segmentation by a combination of characteristics of interest-only mortgages.

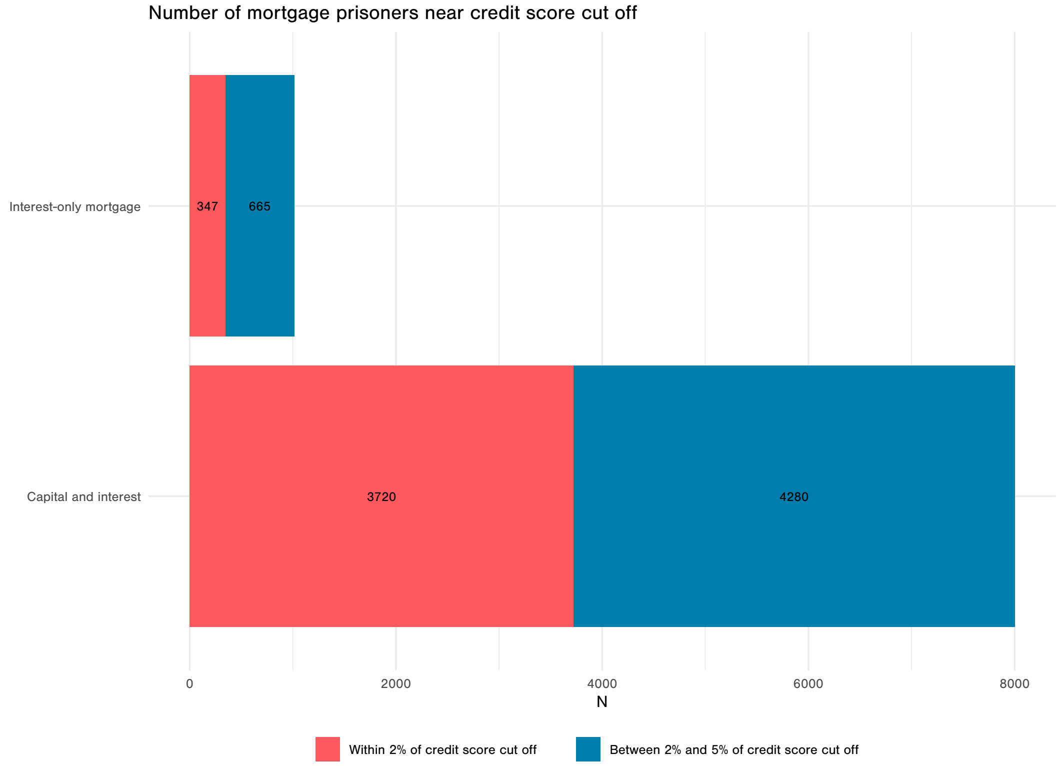
Near credit score cut off

4.54 We look at how many mortgage prisoners may be able to switch if lenders flexed their risk appetite, or borrowers improved their credit status (eg pay down debts and ensure payments are made). We focus on those mortgages where credit score is the key reason why they cannot switch, so we exclude those interest-only mortgages with an LTV above 50%.

4.55 We find up to 9,000 (19%) (1,000 interest-only and 8,000 capital and interest repayment) mortgage prisoners within 5% of the credit score cut off for their LTV band that we use to identify whether a mortgage can be switched (see Table 1). Of these, up to 4,000 (9%) (around 350 interest-only and 3,700 capital and interest repayment) mortgage prisoners are within 2% of the credit score cut off.

4.56 Figure 14 breaks this down by repayment type.

Figure 14



Note: There are relatively few observations in our sample for interest-only mortgage prisoners with a credit score close to the cut-off and a mortgage LTV of less than 50%.

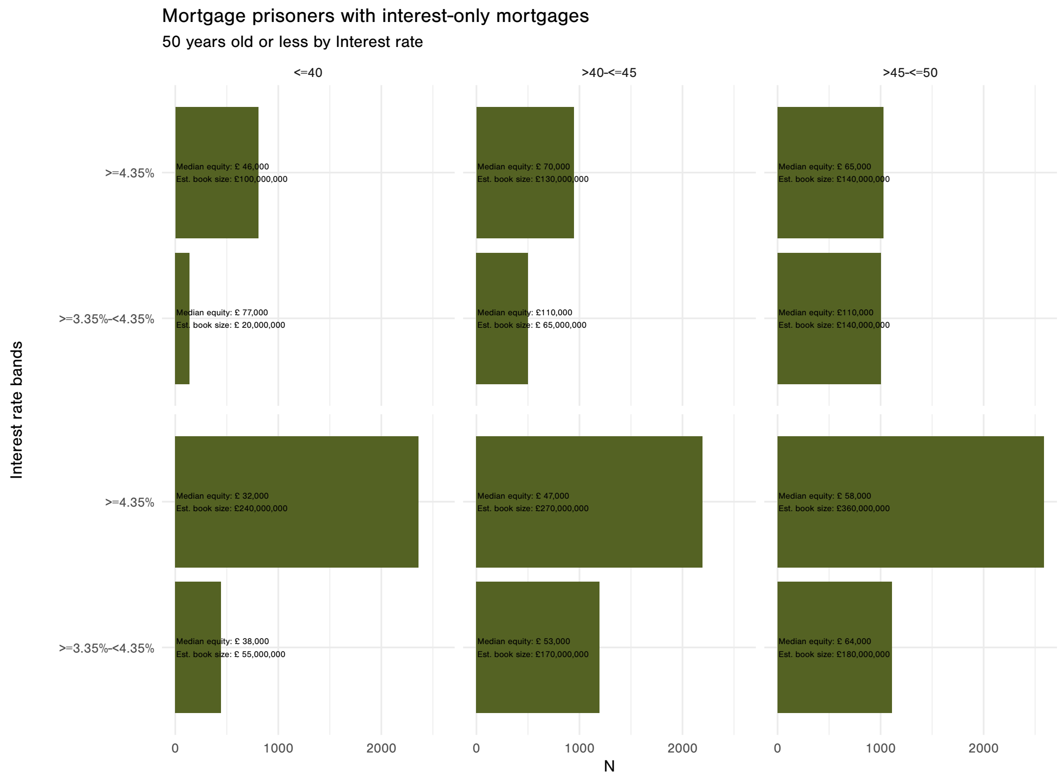
Conversion to a capital and interest repayment mortgage

4.57 One reason a mortgage prisoner with an interest-only mortgage may be unable to switch is because they do not currently have a strategy to repay the capital (amount) borrowed at the end of the mortgage term. One option might be to switch by converting the mortgage to a capital and interest repayment mortgage (where the amount borrowed is repaid over time within the monthly payment). This may be possible for some while for others the increase in monthly payments, to include a monthly repayment of the capital borrowed, may not be affordable. An alternative option might be to switch to a part and part mortgage where the mortgage is a mix of interest-only and capital and interest repayment. This may be more affordable than switching to a full repayment mortgage and so make it more likely that a borrower could switch.

4.58 The borrowers more likely to be able to switch to a capital and interest repayment mortgage will be those who have scope to extend the term of the mortgage to repay the balance over an extended time. This is because they are more likely to be able to afford the increased repayments if they are spread over a longer period of time. Any increase in payments may also be partially offset if the borrowers can switch to a lower interest rate.

4.59 Figure 15 shows a breakdown of the characteristics of mortgage prisoners with interest-only mortgages who are 50 years old or under. We look at those 50 years old or under because these borrowers might have more scope to convert to a repayment mortgage over an extended term. These borrowers may therefore have some scope to extend mortgage terms to make monthly payments more affordable. Conversion to a capital repayment mortgage may be less affordable for those who are older and may need to repay over a shorter term (especially if income drops in retirement).

Figure 15: Potential conversion to capital and interest repayment mortgages



4.60 Those mortgage prisoners more likely to be able to convert and switch to a capital and interest repayment mortgage (provided they could afford higher monthly payments) are those who do not have impaired credit. For example, Figure 15 shows that we estimate there are more than 2,000 mortgages within each of the three age groups (and 7,100 in total) paying interest rates above 4.35% (and not credit adverse, ie they have a credit score above the 5th percentile of switchers in the same LTV band, as defined at paragraph 3.5). We show this because the rate borrowers pay will be relevant to firms when considering whether they can offer deals at a price which is lower than the rates mortgage prisoners currently pay. These borrowers may have the most to gain by switching to a repayment mortgage, if they can afford to, as they may be able to reduce their interest rate.

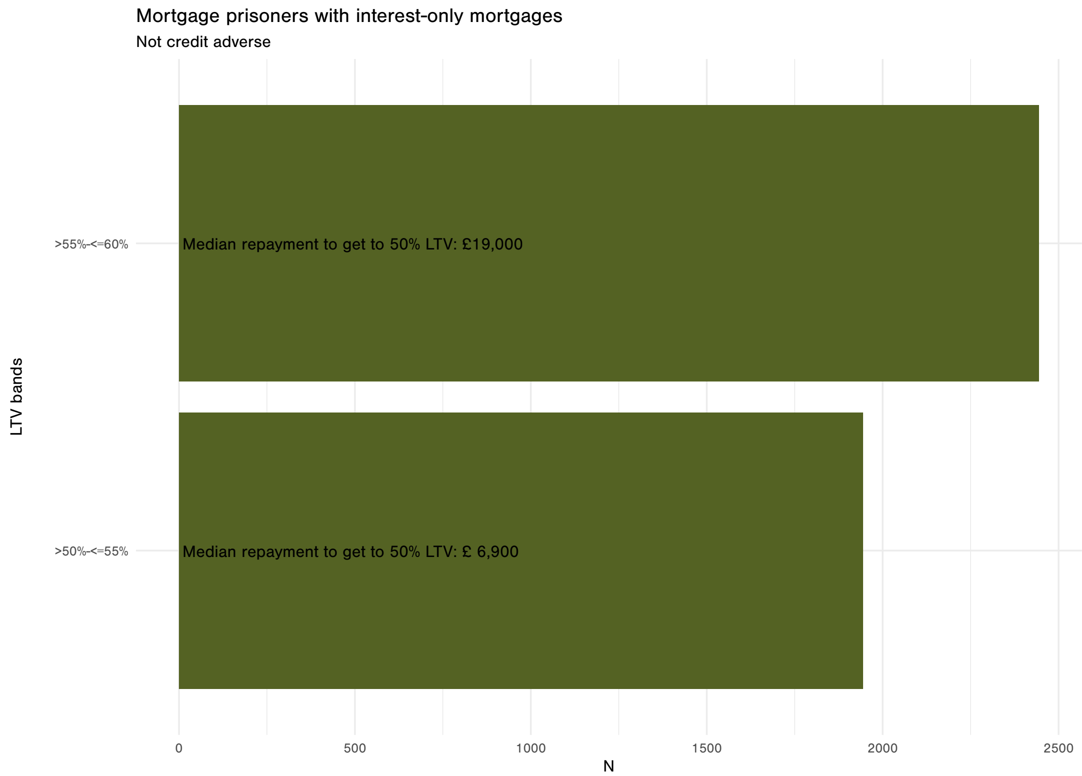
4.61 Further, there are another 2,800 similar borrowers who are paying between 3.35% and 4.35%. Although switching to a capital repayment mortgage will increase the monthly payments (because of the inclusion of a monthly repayment of capital), they may be able to partially offset the increase in monthly payments by switching to a lower interest rate. In total there are 9,900 interest-only mortgage prisoners who are 50 years old or less and are not credit adverse.

Enabling switching by repaying capital

4.62 Another option in marginal loan-to-value interest-only mortgage cases, where the borrower has almost enough equity to qualify for a switch on interest-only terms, might be to make a partial capital repayment to reduce the LTV. Using an hypothetical example, if the amount owed is £125,000 and the value of the property is £240,000, the maximum a new lender may agree to lend on an interest-only basis (with no current strategy to repay the capital at maturity) might be £120,000. If a borrower can repay £5,000 to reduce the amount they need to borrow to £120,000, they may be able to switch to a better deal. If a borrower can obtain a lower interest rate on a new deal this may give them more scope to pay back additional capital over time or provide more options at the end of the mortgage term when the remaining loan must be repaid.

4.63 For some mortgage prisoners, paying down a proportion of the capital to reduce LTV may mean they become eligible to switch. Figure 16 shows for non-credit adverse borrowers how many mortgage prisoners with interest-only mortgages might become eligible to switch if they paid down some of their balance.

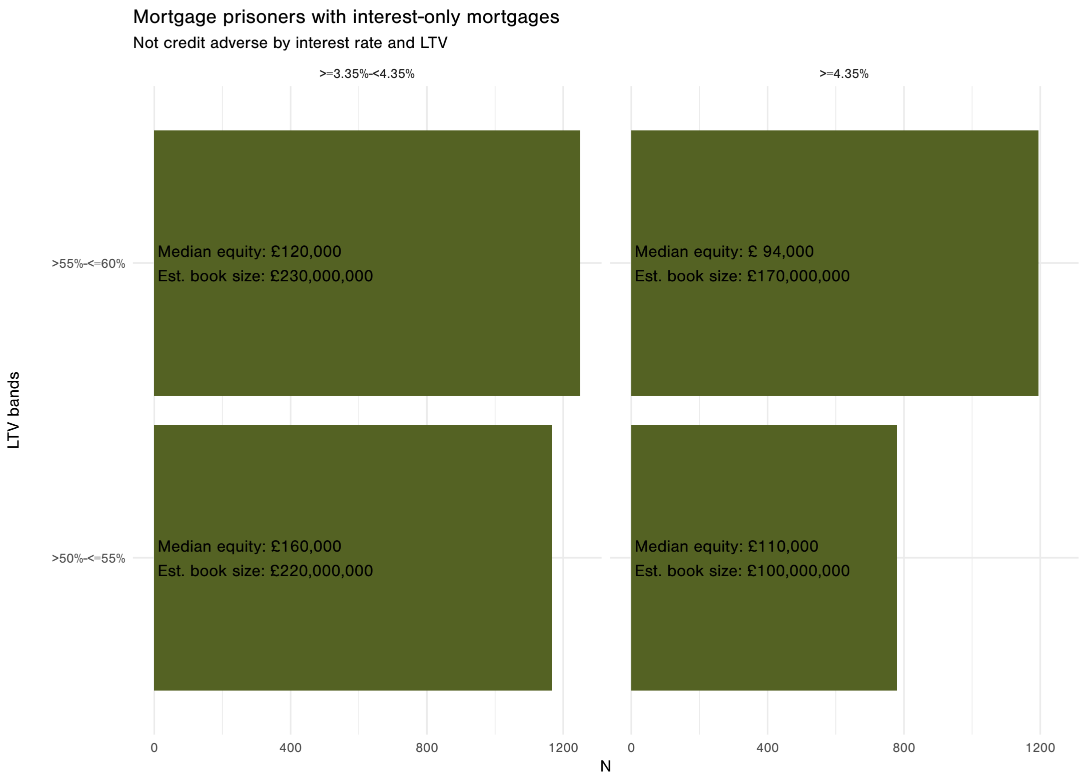
Figure 16: Equity required for interest-only mortgages to reach 50% LTV



4.64 We estimate that there are almost 2,000 interest-only mortgages that are not credit adverse and close to the 50% LTV threshold (ie those in the 50-55% LTV band). The median capital repayment amount required for these borrowers to meet the 50% LTV threshold is £6,900. If these borrowers were able to pay down sufficient capital (or switch to a part repayment, part interest-only product) to lower their LTV they could become eligible for interest-only deals that do not require a repayment strategy, and therefore access lower interest rates in the active market.

4.65 Figure 17 shows this data again but split by interest rate and considers the scope for lenders to increase the maximum LTV for lending on an interest-only basis where the borrower has no strategy to repay the capital borrowed (other than the sale of the property). We look at how many mortgage prisoners are close to the typical current assumed LTV threshold of 50% LTV. We estimate that there are around 800 borrowers with an interest-only mortgage close to the 50% threshold paying in excess of 4.35% (with median equity of £110,000 and total balances of £100 million), with a further almost 1,200 paying between 3.35% and 4.35%. We note that if lenders were willing to lend above 50% LTV on this basis, they may charge a higher rate of interest so borrowers might save less from switching when compared to the rates they may obtain if they were able to reduce the amount they need to borrow to less than 50% LTV.

Figure 17: Mortgages close to the 50% LTV threshold



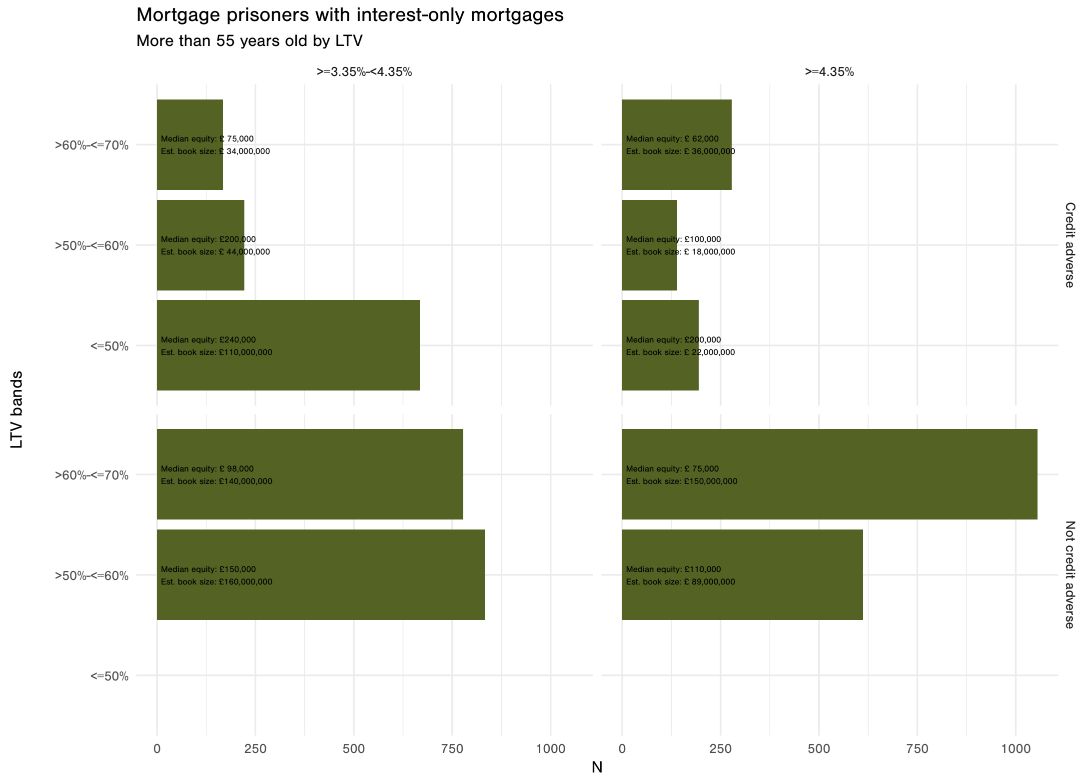
Potential conversion from interest-only to a retirement interest-only mortgage

4.66 Those consumers on interest-only mortgages that are close to retirement age might be able to switch to a retirement interest-only mortgage (RIO). With a RIO the borrower commits to making ongoing payments of interest, but repayment of the capital is deferred until certain events occur, such as the borrower dying or the property being sold. Because of this, there is no need for the borrower to demonstrate a credible repayment strategy other than the eventual sale of the property. However, a RIO will only be an option where the borrower can show that the interest payments will remain affordable for them, and lenders will need to have regard to whether the income might reduce on retirement (or the death of a joint borrower).

4.67 Lenders will typically limit RIOs to 50%-60% LTV (there are fewer retirement interest-only mortgages available for higher LTV mortgages). Figure 18 shows a breakdown of mortgage prisoners with interest-only mortgages over the age of 55, and with LTV below 70%. We again split the segments into those borrowers paying either more or less than 4.35%, because the rate borrowers pay will be relevant to firms when considering whether they can offer deals at a higher LTV at a price which is lower than the rates mortgage prisoners currently pay.

4.68 Borrowers with mortgages with LTV close to 50% and not credit adverse are those most likely to be eligible for a RIO. Those with higher LTVs or who are credit adverse are less likely to be eligible for a RIO. There are around 1,400 mortgages held by prisoners who are over 55, without adverse credit and with an LTV below 60%: 600 who are paying more than 4.35% and around 800 who are paying less than 4.35%.

Figure 18: Potential conversion from interest-only to a retirement mortgage



4.69 Lifetime mortgages might also be an option for mortgage prisoners approaching, or in, retirement, but loan-to-values for these products are even lower than 50% (especially for those near retirement rather than in later retirement) and these mortgage prisoners do not typically have enough equity to access these.

Conclusions on the segmentation analysis

4.70 In summary, we think some of the 47,000 mortgage prisoners might be able to switch on to new mortgage deals, if lenders adapted their lending criteria or interest-only borrowers considered whether they could repay some capital or convert to a capital and interest repayment mortgage or switched to a retirement interest-only product.

4.71 We estimate that up to around 6,000 mortgages held by mortgage prisoners might be close to the risk appetite of lenders. These mortgages are from two groups:

- around 4,000 mortgages where the first borrower is within 2% of the minimum credit score to enable them to switch
- around 2,000 interest-only mortgages (not credit adverse) with LTV between 50% and 55%. (We note that these mortgage prisoners may be able to repay some capital and this may enable them to switch without lenders changing their risk appetite.)

4.72 We also think that there are interest-only mortgages held by mortgage prisoners who cannot switch on a like for like basis but who might be able to switch if they could convert to a capital and interest mortgage or repay some capital or switched to a retirement interest-only product. We are not estimating the overall number of mortgages that might be able to switch on this basis because of overlaps in the groups.

Appendix 1
Data, matching and characteristics of the matched sample

1. We combined three datasets to enable us to identify mortgage prisoners and analyse their characteristics. The process of combining these datasets gave us a sample of the entirety of mortgages with outstanding balances as of the first half of 2021, from which we were then able to identify mortgage prisoners and other relevant groups of borrowers in the market. We used:

- Mortgage performance Product Sales Data (**PSD007**)
  - PSD007 contains information on all regulated outstanding mortgages and is updated every 6 months. We use the 2021 H1 snapshot as the starting point for our analysis, excluding closed accounts and second charge mortgages. This initial dataset is made of approximately 8.5m mortgages.
- Mortgage origination Product Sales Data (**PSD001**)
  - Some mortgage information, such as the value of the property or whether the borrower's income was verified, is only collected at origination. These variables are reported in PSD001, which is updated every quarter. For this analysis we focus on PSD001 originations from 2005 Q2 (the first quarter this was reported) up to 2021 Q2 and we exclude second charge mortgages. Approximately 7.4m PSD001 mortgages are matched with PSD007.
- Credit Reference Agency data (**CRA**)
  - CRA data is a random 10% sample of records from a credit reference agency. The data contain credit items recorded on credit files for a 6-year period up to December 2020. We use only the credit reference agency records for those with a mortgage within scope of this analysis. Approximately 1.47m unique mortgages are found in the CRA data.
  - We find more than 10% of the total number of mortgages because jointly held mortgage accounts appear across multiple credit reference agency files and are therefore more likely to appear in the sample.

2. The variables we have used for matching are listed in the relevant sections. The unit of observation is 'mortgage' but some of the variables we use to identify mortgage prisoners is individual-level data for the borrower identified in PSD007, usually the borrower identified as the 'first borrower' in PSD007. By first borrower, we mean the borrower named first on the mortgage account where there are joint borrowers.

3. From the CRA data set we use data from three tables:

- *lookup:* data for sampled individuals and their associates
- *products:* data for all products each individual holds and that are reported by the firm to the CRA:
  - we exclude buy-to-let and second charge mortgages from this table, as well as all non-mortgage products
  - we also keep only mortgage accounts open as of December 2020

- *performance*: monthly data for each product containing the up-to-date reported balance.

4. The *lookup* and *products* tables are merged, keeping only the mortgage accounts for those in the CRA primary sample[10]. To help with matching with PSD data we add data, such as dates of birth and postcodes, for financial associates where the mortgage was held jointly.

5. We keep only one row for each mortgage account. To avoid duplicate records, when two or more rows have the same date of birth, postcode, firm reference number (FRN) and account open date, we keep the row with the largest mortgage balance. This ensures the CRA data aligns with the approach to reporting split mortgages detailed in SUP 16 Annex 21R. 61,000 rows are removed.

Combining the datasets

6. We set up a matching process to link as many rows as possible in PSD007 to corresponding entries in PSD001 and CRA. These datasets are collected separately and, in the case of CRA data, by a different organisation. Therefore, no explicit link exists to connect mortgages in one dataset with mortgages in the other dataset. To combine these data sources together, we use a record linkage algorithm, using a subset of variables from both datasets that we expect to match.

7. A record linkage algorithm can be deterministic or probabilistic. In a deterministic algorithm, we require a subset of columns in both datasets to match exactly. Rows that do not find an exact match in the other dataset are discarded. With a probabilistic algorithm, all rows in one dataset are compared with all rows in the other dataset and a statistical measure of similarity is estimated for each of the row combinations (rows for which several columns exactly match will have a high similarity score). Once a similarity threshold is chosen, all combinations above that threshold are considered linked and all combinations below the threshold are discarded.

8. While a probabilistic linkage is theoretically more appealing, it requires significant computing resources, especially when millions of rows need to be combined, as in our case. (The computational burden can be somewhat reduced by "blocking" some columns, ie requiring an exact match on a further subset of variables. However, with our datasets any sensible blocking would still generate several million combinations and require substantial computing power.) Given this we adopt a deterministic approach to link PSD007 rows (or mortgage accounts) with PSD001 and CRA.

The closed book population

9. Since the 2021 H1 reporting period, we are able to identify mortgages in closed books using a flag in PSD007 that indicates whether or not they are part of a closed book. We manually checked the firms who were reporting mortgages in that group and compiled a list of inactive firms for our relevant population. Firms with specific business models will report their books as being closed, eg lifetime mortgage lenders, but we want to restrict the sample to the closed books with inactive firms for the mortgage prisoners analysis. We also included closed books at active firms where the mortgages have

10 The 10% sample is of all individuals in the credit reference agencies records (the primary sample). In addition to this sample, we also receive information on individuals with financial associations with the individuals in the 10% sample, e.g. by virtue of holding a mortgage jointly.

been securitised and there are covenants preventing internal switching. Our closed book population is made up of c.195,000 mortgages and 34 firms.

PSD001 and PSD007

10. PSD007 and PSD001 are linked based on a unique key, which is created by concatenating full postcode, date of birth of the main borrower and origination date in both datasets. This is to ensure that postcodes in data reported at potentially very different times (and possibly by different firms) match. Each set is deduplicated before the match; following the approach detailed in paragraph 5 of this appendix, if there are duplicates in PSD001, the mortgage with the highest loan value is kept; in PSD007, the case with the highest outstanding balance is kept. This is to avoid the same balance being reported more than once in the data. This does not affect the size of the closed book population and has little impact on the size of wider active book population. As a result of this matching process, 7.4m rows in PSD007 and 145,000 mortgages in the closed book population are matched to information in PSD001. We do not match all the 195,000 mortgages in closed books with inactive lenders we identify in PSD007 because either the mortgage was initiated prior to PSD001 being collected, and therefore we do not have origination data, or data quality issues prevent a mortgage being matched to its origination data in PSD001 (for example an error in its postcode) (see section 2).

PSD and CRA

11. We match CRA data to the matched PSD007-PSD001 snapshot using a deterministic approach in three rounds. At the end of each round, we put the matched mortgages on one side and the unmatched ones on the other. We perform the subsequent round on the unmatched mortgages.

12. In the first round, we look for exact matches on date of birth of the main borrower, full postcode, original balance of the mortgage (rounded to the nearest £10,000), origination year and lender.

13. In the second round, we keep all the initial matching criteria except the one on date of birth. Rather than matching on the date of birth of the primary sample CRA borrower, we look for matches between the date of birth in PSD007 and the date of birth of the associated borrower in CRA (if any). For joint mortgages, either of the two borrowers could end up in the CRA sample and we do not know which one had the date of birth recorded in PSD007. (There could be mortgages with more than two joint borrowers but those are extremely rare, so we do not consider them in our code.)

14. In the third round, we use date of birth of the main borrower, full postcode, original balance of the mortgage (rounded to the nearest £10,000), origination year as in the first round but exclude the lender. We use this approach because mortgages have in many circumstances been transferred between providers. This enables as many matches as possible but will be unlikely to result in many, if any, false matches.

15. Our linkage algorithm, using these three rounds, matches approximately 10% of PSD007 rows ie 771,000 out of 8.5m and 5% (6,300) of mortgages in the closed book population of around 195,000 mortgages. We discuss the reasons for this lower matching rate in section 2 of this annex.

16. Using the CRA data, we are able to identify borrowers with Together mortgages by matching mortgages with personal loans that were taken out by the same borrower, from the same lender on the same day as the mortgage was taken out.

Characteristics of the matched data

17. To evaluate the linkage algorithms we used to create the matched PSD and CRA dataset, we present two analyses of the characteristics of the matched sample. Table 18 compares the characteristics of the whole matched sample (closed and active books) with all mortgages in PSD007 (closed and active books). Table 20 compares the characteristics of the subset of closed books in the matched sample and closed books in PSD007.

Table 18: Comparison of matched sample of all mortgages and all mortgages in PSD007

	Full match (N=771,000)	Overall (N=8,505,000)
Matched firms (count)	71	177
Origination year (median)	2017	2016
First borrower date of birth (median)	1977	1976
Gross rate of interest, % (median)	2.060	2.090
Repayment type (count)		
Capital and Interest	699,270 (90.8%)	7,364,727 (86.5%)
Interest-Only	50,970 (6.6%)	864,135 (10.2%)
Mix of Capital and Interest, and Interest-Only	20,584 (2.7%)	276,246 (3.2%)
Current outstanding balance, £ (median)	122,000	111,386
Remaining term in months (median)	222.0	204
Current payment shortfall, £ (median)	0	0

18. We observe that there are some differences in the matched sample compared to the overall population of mortgages in PSD007. There are many fewer reporting firms in the matched dataset. This is driven by some firms not reporting to the credit reference agency we obtained the data from. Additionally, we see that mortgages in the matched sample have, on average:

- An almost identical median interest rate
- A lower proportion of interest-only mortgages
- Slightly larger median outstanding balances
- Longer median remaining terms
- A slightly shorter median period since origination

19. There are various reasons why we observe these differentials. There may be some differences in the books of firms reporting to the CRA compared to the overall population. Additionally, older mortgages originated before 2005 will not appear in PSD001 and therefore will not appear in the matched data.

20. We use this population to identify the credit scores for mortgages holders that have recently switched. This enables us to assess whether a mortgage holder in a closed book has a credit score at least as high as recent switchers and may therefore be able to switch in the open market. We also use the wider data to identify the interest

rates paid by active book borrowers and compare them with those paid by mortgage prisoners.

21. Table 19 shows a similar analysis to the previous table but compares our matched sample for closed books held by inactive firms with the population of mortgages in closed books held by inactive firms.

Table 19: Comparison of matched with all mortgages in closed books

	Full match (N=6,300)	Overall (N=195,000)
Matched firms (count)	10	34
Origination year (median)	2006	2006
First borrower date of birth (median)	1970	1969
Gross rate of interest, % (median)	4.140	3.020
Repayment type (count)		
Capital and Interest	3,337 (52.5%)	88,027 (45.2%)
Interest-Only	2,952 (46.5%)	104,078 (53.5%)
Mix of Capital and Interest, and Interest-Only	62 (1.0%)	2,448 (1.3%)
Current outstanding balance, £ (median)	85,610	87,670
Remaining term in months (median)	122.0	120.0
Current payment shortfall, £ (median)	0	0

22. There are 34 firms in the closed book population. Table 19 shows that, of these, 10 are in the matched sample. The 10 firms that are included in the matched sample cover 63% of the closed book population, around 123,000 mortgages. Of the 24 firms not in the matched sample, 17 do not appear in the CRA data at all. For the 17 firms that do not appear in the CRA data, any change of the record linkage algorithm would not improve the matching rate, if the reason for the absence of these firms is that they do not report to that specific CRA. If the reason is a mismatch in FRNs, the third matching round of our linkage algorithm (which does not rely on FRN) would have captured those cases. These 17 firms tend to have relatively few mortgages compared to those firms we have matched. Consequently, even if the firms were different to the closed book population (and they do not seem to be, looking at the matched and unmatched data in Table 19), we do not think that these differences would materially affect our estimate of the number of prisoners or our assessment of their characteristics.

23. Additionally, we observe that most of the characteristics of the matched sample and the closed book population are similar except for:

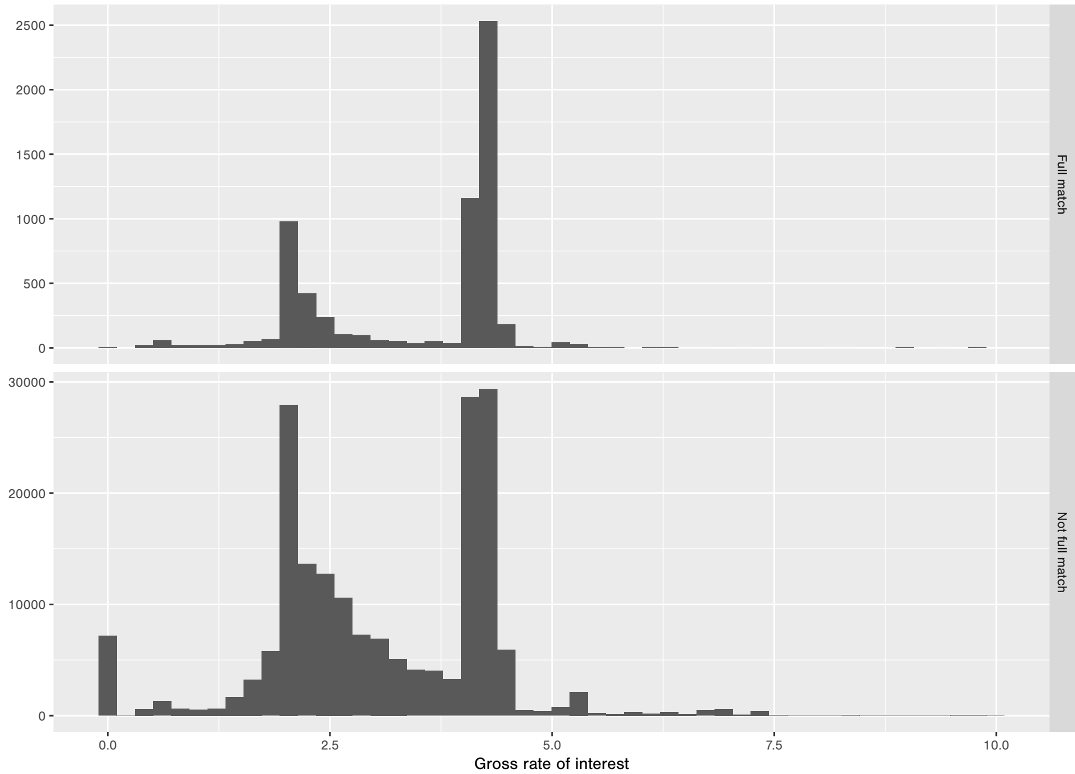
- the median interest rate on the matched sample is higher
- the proportion of interest-only mortgages in the matched sample is lower than in the closed book population.

24. Figure 19 shows the distribution of the interest rates for the fully matched sample and for the unmatched mortgages within the closed book population. We can see a similar shape to the distribution. The key difference is that we observe proportionally fewer mortgages at around 2% in the matched sample. This is what is driving the higher median interest rate for the matched sample that we observe in Table 19. The shape of

the distribution makes the median sensitive to variations in sampling because relatively few mortgages are located in between the two peaks of the population.

25. By having fewer mortgages at 2% in our sample we are overestimating the number of prisoners. Since by definition borrowers paying 2% are not mortgage prisoners, if we had a more representative number of mortgages at 2% in our sample, the number of prisoners would be lower.

Figure 19: Distribution of interest rates in matched and unmatched closed book mortgages



26. There are around 7 percentage points fewer interest-only mortgages in the sample than in the overall population. To assess the impact of this bias we consider the maximum impact this might have. Interest-only mortgages are more likely to be prisoners. If all these 'missing' mortgages were mortgage prisoners, then we might have 7 percentage points more prisoners in the sample. This implies our estimate of the number of mortgage prisoners would increase by a maximum of around 10,000 (closed book population not in arrears or payment shortfall, 143,000, multiplied by 7%). Given this is the maximum impact, we do not think the bias in interest-only mortgages is material.

27. To test this further, we compared interest-only mortgages in our sample to interest-only mortgages in the closed book population. The two groups look similar on their characteristics (see Table 20). Again, the mortgages appear similar but with higher interest rates in the matched sample (with similar implications, ie an overestimate of the numbers mortgage prisoners).

Table 20: Comparison of interest-only mortgages in the matched sample and in the closed book population

	Full match (N=2,951)	Not full match (N=101,177)
Origination year (median)	2006	2006
First borrower date of birth (median)	1969	1968
Gross rate of interest, % (median)	3.84	2.74
Repayment type		
Interest-Only	2,951 (100.0 %)	101,177 (100.0 %)
Current outstanding balance (median)	133,251	130,463
Remaining term in months (median)	117	117
Current payment shortfall (median)	0	0

28. Table 21 shows the characteristics of the mortgages held by firms that report to the CRA and those that do not. We observe that there are no meaningful differences in the two groups. This gives us confidence that there are no material differences in the mortgages held by firms who report to the CRA and those that do not. Again, the exception to this is the interest rate. As noted before, the missing firms are more likely to charge lower interest rates. We have discussed the implications of this at paragraph 25 above.

Table 21: Comparing firms in the matched sample to unmatched firms

	Firm within sample (N=123,210)	Firm not in sample (N=71,415)
Origination year (median)	2006	2007
First borrower date of birth (median)	1970	1967
Gross rate of interest, % (median)	4.14	2.62
Repayment type		
Capital and Interest	55,469 (45.0 %)	32,577 (45.6 %)
Interest-Only	65,923 (53.5 %)	38,205 (53.5 %)
Mix of Capital and Interest, and Interest-Only	1,818 (1.5 %)	633 (0.9 %)
Current outstanding balance (median)	88,950	85,692
Remaining term in months (median)	120	119
Current payment shortfall (median)	0	0

29. In conclusion, using a sample to estimate the number of mortgage prisoners and then assess their characteristics does lead to some uncertainty in our estimates. However, we believe that there is benefit from matching with CRA data as we can only assess ability to switch by gaining information on the creditworthiness of borrowers. The analysis we generate is the most comprehensive we can provide, and we have a reasonable understanding of the data limitations to factor these into our conclusions. We do not think that the uncertainty means that our estimate of the number of mortgage prisoners is materially different from the true number in the population. That is, around a quarter of the closed book population are mortgage prisoners.

Using the sample to provide population estimates

30. To estimate the number of mortgage prisoners we scale up our sample to the number of mortgages in the closed book population excluding mortgages in payment shortfall or near term. The number of mortgages presented as being in payment shortfall or near term in Figure 1 are population figures taken directly from the closed books analysis of PSD data at Annex 1. The remainder of the figures in the 'waterfall' chart (including the number of mortgage prisoners) are estimates, obtained by scaling up the numbers in each category in our sample to the mortgages in the population that are not in payment shortfall or near term.

31. Table 22 shows the numbers of mortgages in our sample of mortgages in closed books and their allocation to the 5 groups described in section 3. The numbers in the population column shows our estimation of how the 195,000 mortgages in closed books are allocated to these groups.

Table 22: Closed book population numbers and percentages

Group	Sample, number	Percentage	Population, number
In shortfall	800*	17	34,000
Near term	300*	9	18,000
Able to switch	2,400	34	66,000
May not benefit from switching	1,100	16	30,000
May benefit from switching	1,700	24	47,000

* Sample weighted so in shortfall and near term the proportions match the proportions observed in the whole closed book population. The percentage column refers to the scaled population, not the sample.

32. We use a different approach to estimate the number of mortgage prisoners with Together mortgages. These mortgages are not identified in PSD data so we have to estimate them. We know (from our knowledge of the market) that only a small proportion of the firms in the closed book population hold Together mortgages. However, we have the firms in the population that have Together mortgages in our sample (since these firms report to the CRA). It would not be right to scale the number of mortgages in the sample to the wider population as this would mean we would estimate that there are more prisoners with Together mortgages than the overall number of Together mortgages. To avoid this, we scale our estimate of the number of Together mortgages differently to our other analyses. We find the proportion of mortgages in the matched sample who are mortgage prisoners with Together mortgages, and then scale this to the number of mortgages in the wider closed book population (not near term or in payment shortfall) that are in the books of the firms we have in our sample.

Calculating credit scores

33. Using the data from the credit reference agency we calculate a credit score. We use this calculated credit score to assess whether borrowers with closed book mortgages could switch their mortgage.

34. To calculate the credit score, we built a model to predict 'delinquency' events on debts ('delinquency' is a technical term: we define a delinquency event as a new entering 90 days or more arrears on any account, account opening with a debt purchasing firm, a new County Court Judgment (CCJ) for the individual or new bankruptcy IVA (Individual Voluntary Arrangement) in the next 12 months), using a model called random forest. The model is a prediction of new delinquency in the next 12 months, using data from the past 24 months.

35. The model produces a probability of delinquency. We then convert this into a credit score. The score conversion is a relatively simple calculation. Our scores are calibrated with a baseline odds ratio of 50:1, a baseline score of 650, and every 15 points will double the odds. That means that a score of 650 means a consumer has a 1.96% chance of a delinquency event in the following 12 months. If the score was 665 (15 points higher) then the odds would be 100:1. This is a 0.99% chance of a delinquency event.

36. We also use credit score bands in our alternative approach to identify mortgage prisoners (see Appendix 2 for how we use these bands). We set the bands so that we observe similar default probabilities for each band compared to the bands used by the CRA.

Appendix 2
Sensitivity analysis

1. In this appendix we list the main assumptions in our analysis of mortgage prisoners and their impact.

Near term mortgages

2. Adjusting the definition of mortgages near the end of term from 'less than 24 months remaining and/or less than £10,000 balance' to 'less than 12 months remaining and/or less than £5,000 balance' reduces the number of near term mortgages from 18,000 to 14,000 mortgages.

Identifying those unable to switch

3. The following outlines the impact of each of our assumptions to identify those unable to switch. We consider the impact of the credit score cut-off and the requirement of a maximum 50% for interest-only mortgages.

Credit score cut off

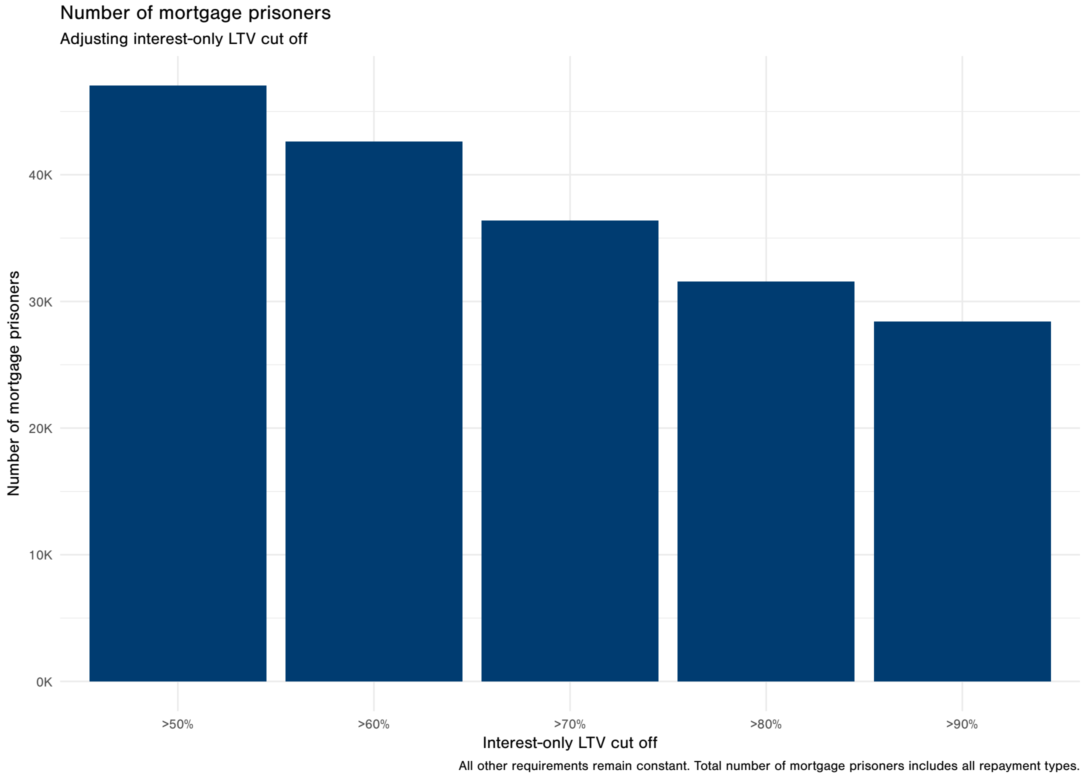
4. An alternative method (instead of the LTV interest-only cap and the 5th percentile approach) is to use hard credit score boundaries to define those able to switch, by assuming that any borrower with a score in the "Poor" or "Very Poor" category is unable to switch. This means any borrower with an estimated score of 606 and above is deemed able to switch and is removed from the pool of potential mortgage prisoners. Using this alternative method, we find 72,000 able to switch and 72,000 unable to switch (note totals do not add up due to rounding), rather than our figure of 77,000 unable to switch. When we use this method, we find 43,000 mortgage prisoners (ie a reduction of 4,000 mortgages).

5. We can also adjust the 5th percentile cut off for credit scores by LTV band to use the 2nd percentile instead. Doing this we find 42,000 mortgage prisoners.

LTV requirement of 50% for interest-only mortgages

6. Adjusting the LTV requirement for interest-only mortgages reduces the number of mortgage prisoners by an average of 4,700 for every 10-percentage point increase. For example, if we assumed the cut off point was 60% LTV rather than 50% LTV (ie only those above 60% would be unable to switch), then the number of mortgage prisoners would be c.42,000 instead of c.47,000 (see Figure 20).

Figure 20



The illustrative rate

7. We identified as mortgage prisoners those mortgages where the interest rate paid was higher than 3.35%. The resulting number of prisoners is not particularly sensitive to the assumption of an illustrative rate of 3.35%, as we observe two peaks in the distribution of interest rates paid in June 2021 by borrowers with closed book mortgages that are unable to switch (one around 2.1% and another between 4% and 4.5%). We could use two alternative benchmark rates of 2.37% and 3.6% to estimate the number of mortgage prisoners (see paragraph 0 in section 3 for why we refer to these interest rates). Using the 2.37% alternative benchmark would result in an estimate of 54,000 mortgage prisoners (ie an extra 7,000 that are mainly interest-only mortgages). Using the 3.6% benchmark would result in an estimate of 46,000 mortgage prisoners (ie a reduction of 1,000).

8. Below we present the key characteristics of mortgage prisoners where they are defined using these benchmarks instead of the 3.35% benchmark.

Table 23: Characteristics of mortgage prisoners defined as paying an interest rate of more than 2.37%*

	Capital and interest (Median)	Interest-only mortgage (Median)
LTV	49% [35%, 58%]	66% [58%, 76%]
Balance	£64,000 [£45,000, £88,000]	£128,000 [£97,000, £171,000]
Remaining term	14 [9, 20]	10 [8, 12]
Monthly repayments	£526 [£410, £699]	£446 [£333, £602]
Equity	£70,000 [£47,000, £110,000]	£63,000 [£35,000, £110,000]
Age	46 [40, 52]	50 [44, 55]
Unsecured debt	£11,000 [£4,000, £23,000]	£10,000 [£2,000, £26,000]

*Lower and upper quartile figures, respectively, are shown in brackets.

Table 24: Characteristics of mortgage prisoners when defined as paying an interest rate of more than 3.6%*

	Capital and interest (Median)	Interest-only mortgage (Median)
LTV	51% [37%, 59%]	67% [59%, 77%]
Balance	£66,000 [£48,000, £89,000]	£128,000 [£98,000, £171,000]
Remaining term	15 [10, 20]	10 [8, 14]
Monthly repayments	£535 [£420, £714]	£475 [£370, £632]
Equity	£67,000 [£45,000, £106,000]	£60k [£33,000, £108,000]
Age	45 [40, 51]	50 [43, 55]
Unsecured debt	£12,000 [£5,000, £24,000]	£11,000 [£3,000, £29,000]

*Lower and upper quartile figures, respectively, are shown in brackets.

Appendix 3
Summary statistics for the 'able to switch'

1. In this appendix, we provide summary statistics on those mortgages in closed books where we think borrowers would be able to switch. These borrowers might be paying a higher interest rate than they would be able to access elsewhere. Some might not realise they could make savings. However, some of these borrowers might not benefit from switching given their interest rate and balance. Other borrowers might not think the effort required to switch is worth the savings (as switching lenders requires more effort than re-mortgaging with a new deal with the same lender). Some of these borrowers will have Together mortgages and that may further dissuade borrowers from switching.

Repayment type

2. We estimate that about 66,000 mortgages in closed books with inactive firms would be able to switch. 80% of these mortgages are capital and interest repayment mortgages.

Table 25

Repayment type	Sample, no.	Percentage	Population no.
Capital and interest	1,900	80	53,000
Interest-only mortgage	470	20	13,000

Interest rate

3. Figure 21 displays the distribution of interest rates for the 66,000 (able to switch) mortgages. The following chart (Figure 22) overlays this with the distribution of interest rates for the unable to switch group. Some consumers are paying relatively low interest rates. We see a significant number of borrowers around 2.1% (and a small number of borrowers paying less than this). For these borrowers, it may not be worth switching as they might not make any savings from doing so, or the savings might be very small. However, the majority of these borrowers on capital interest repayment mortgages are paying over 4%. These borrowers would likely be able to obtain lower interest rates if they switched to introductory rates (and benefit from doing so).

Figure 21

Distribution of interest rates for those able to switch

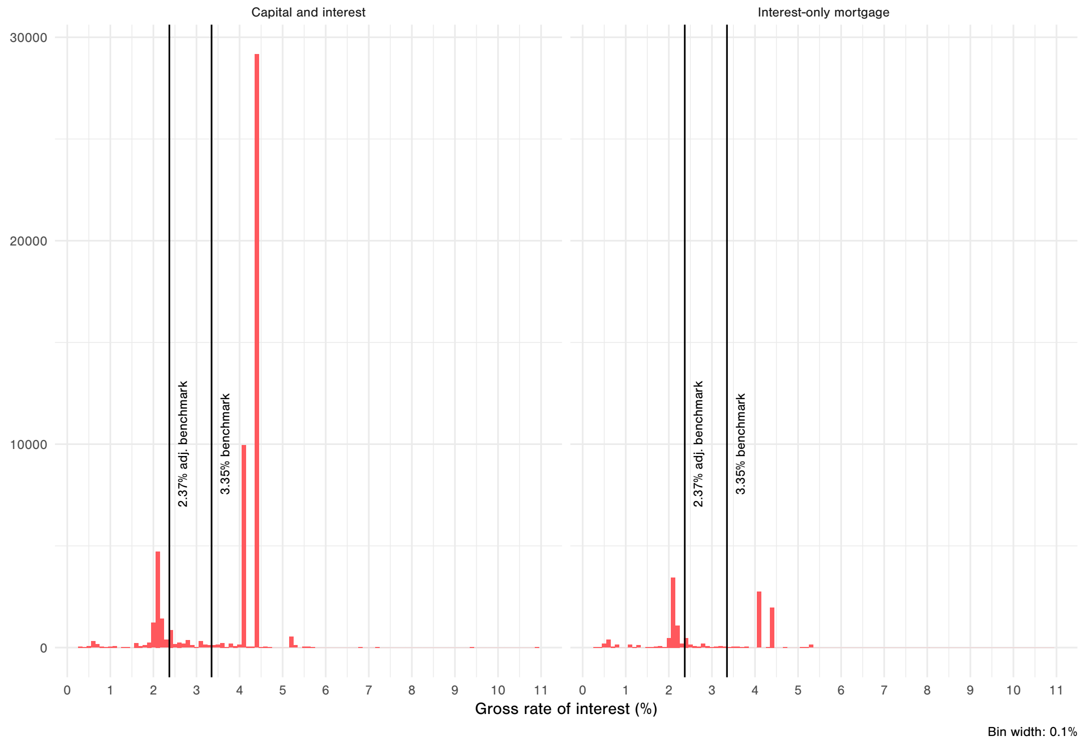
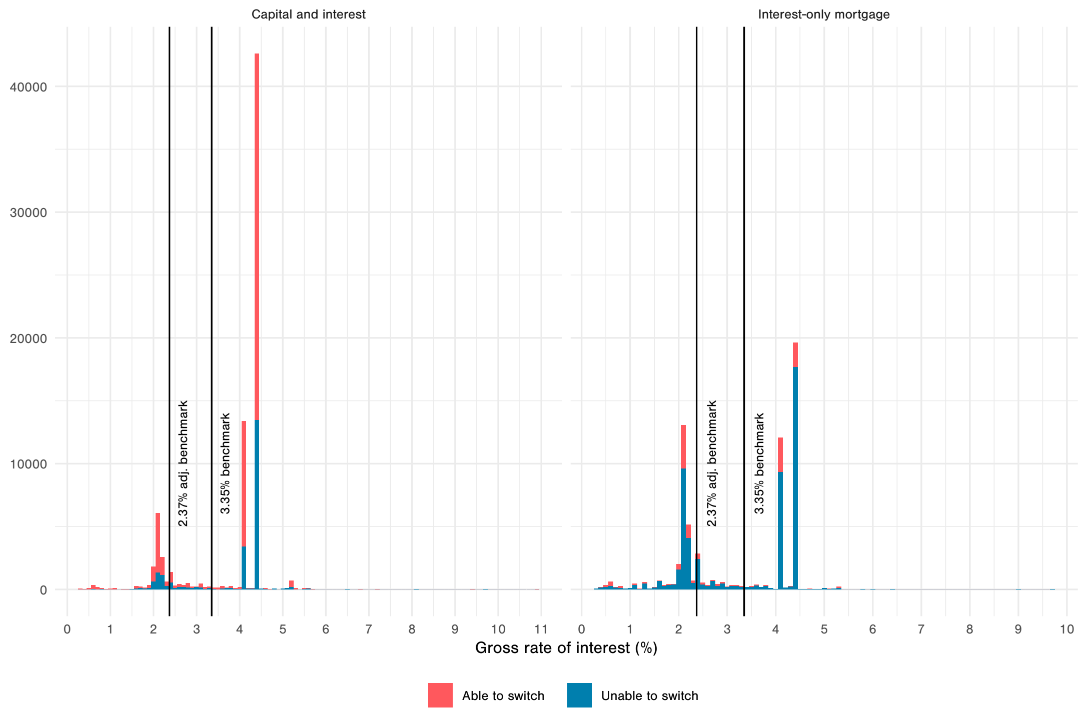


Figure 22

Distribution of interest rates
Able to switch and unable to switch



4. Table 26 shows the summary statistics for the interest rates of the 'able to switch' group broken down by repayment type.

Table 26: Distribution of 'able to switch' interest rates

	Min.	1st Qu.	Median	Mean	3rd Qu.	Max.
Capital and interest	0.34	4.14	4.38	3.84	4.38	10.94
Interest-only mortgage	0.34	2.10	2.34	2.91	4.14	5.34

5. Table 27 includes the key characteristics for the 'able to switch' mortgages.

Table 27: Key characteristics for 'able to switch' mortgages

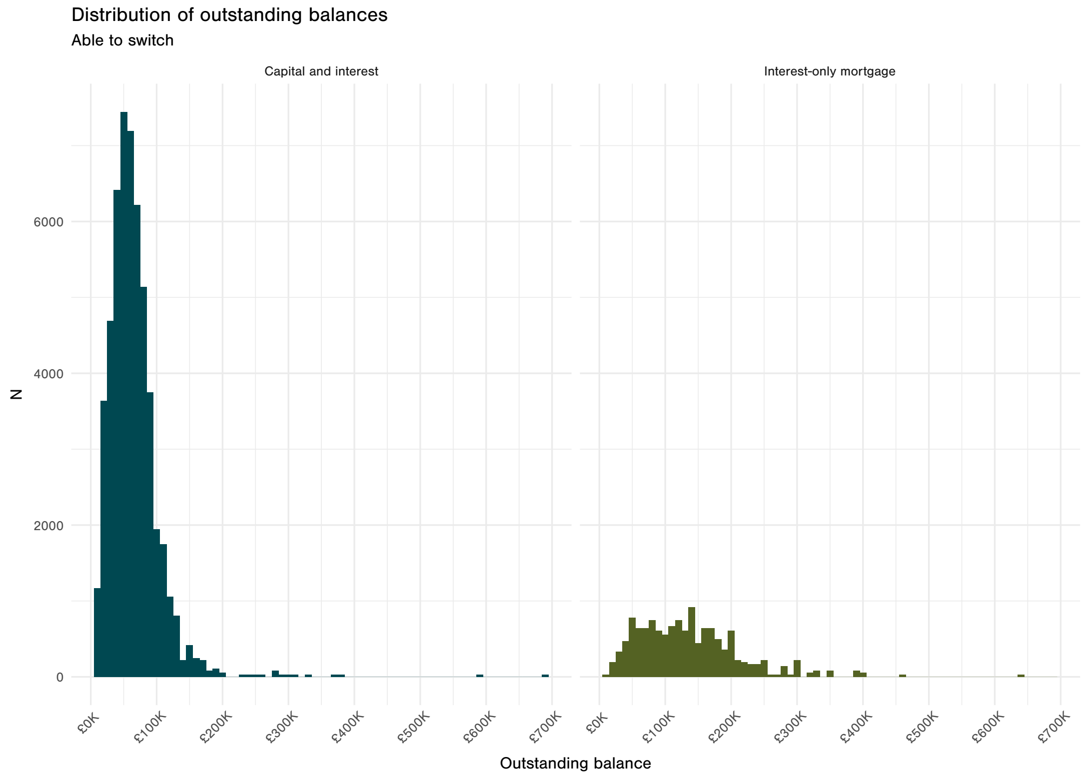
	Capital and interest Median [Lower quartile, Upper quartile]	Interest-only mortgage Median [Lower quartile, Upper quartile]
LTV	42% [28%, 55%]	42% [33%, 46%]
Balance	£59,000 [£41,000, £81,000]	£127,000 [£77,000, £177,000]
Remaining term	11 yrs [9, 17]	10 yrs [6, 10]
Monthly repayments	£513 [£402, £689]	£310 [£205, £506]
Age	48 yrs [41, 55]	54 yrs [47, 59]
Equity	£82,000 [£51,000, £136,000]	£197,000 [£129,000, £265,000]
Unsecured debt	£9,000 [£2,000, £22,000]	£3,000 [£200, £17,000]

Outstanding balance

Table 28: outstanding balance for those 'able to switch'

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	40,800	59,400	65,100	80,700
Interest-only mortgage	77,300	127,000	136,000	177,000

Figure 23

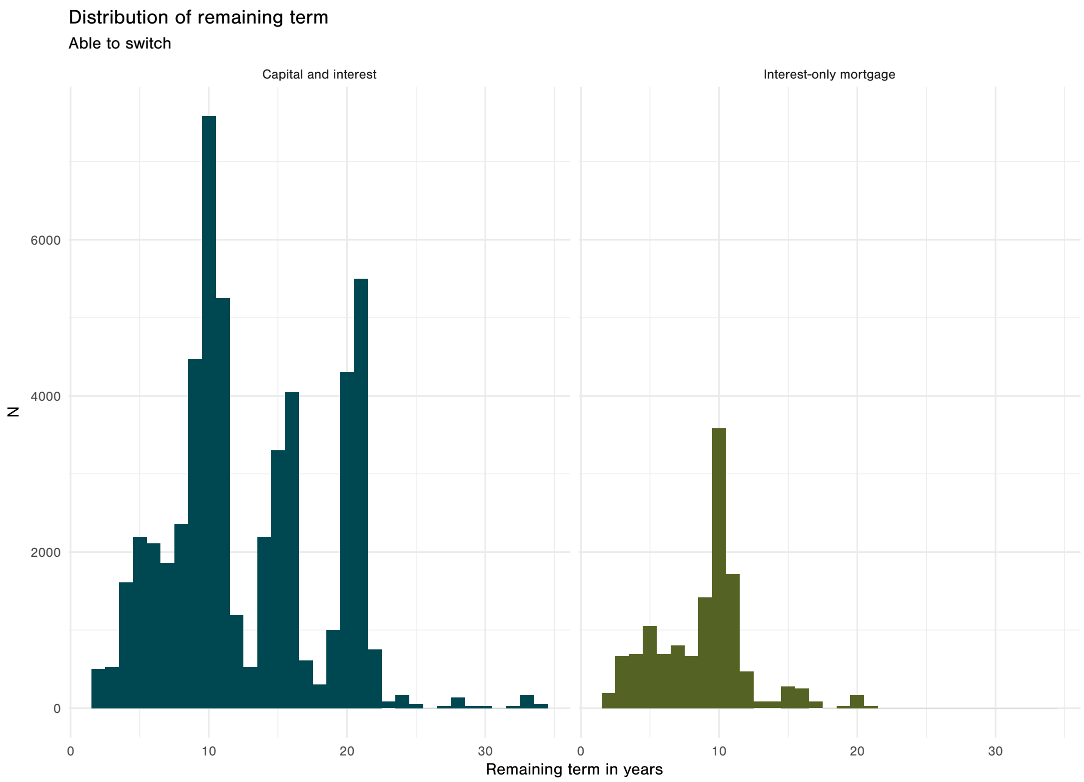


Remaining term

Table 29: Remaining terms for 'those able to switch'

	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	9	11	13	17
Interest-only mortgage	6	10	9	10

Figure 24

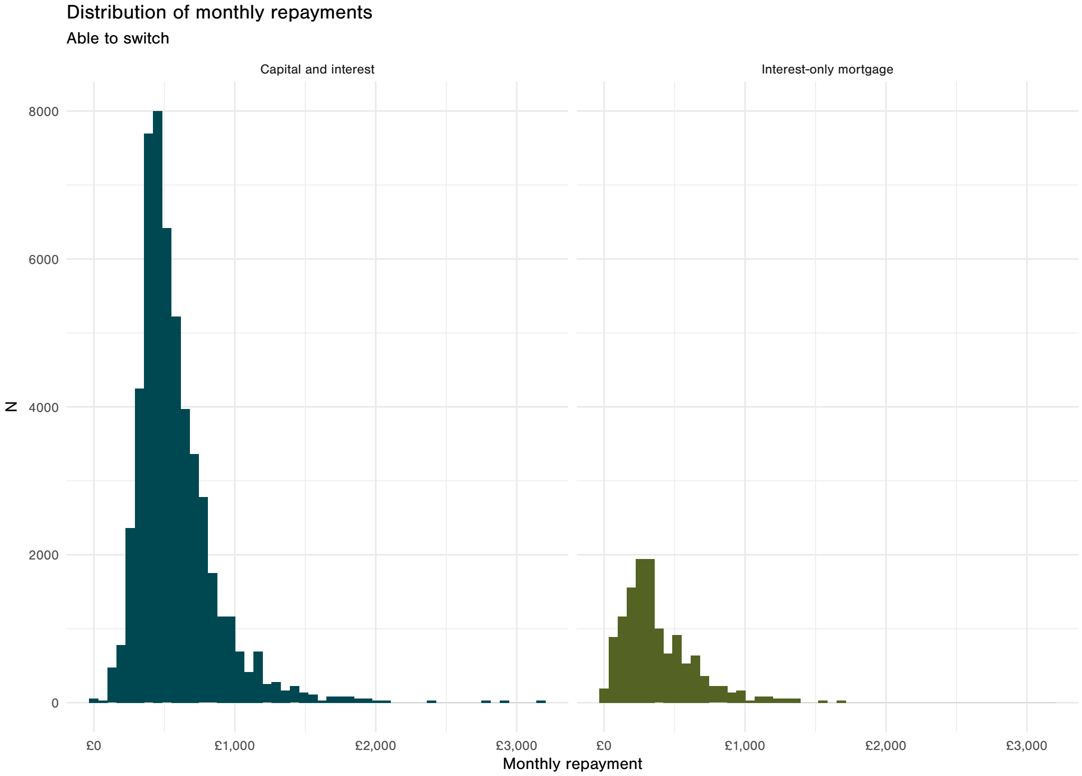


Monthly payments

Table 30: Monthly payments for those able to switch

Repayment type	1st Qu.	Median	Mean	3rd Qu.
Capital and interest	402	513	578	689
Interest-only mortgage	205	310	381	506

Figure 25


Distribution of monthly repayments
Able to switch
Capital and interest
Interest-only mortgage
8000
6000
4000
2000
0
N
£0
£1,000
£2,000
£3,000
Monthly repayment

Annex 3
Effect of regulatory interventions

1. We have reviewed the effect of our interventions to remove regulatory barriers to switching to make it easier for lenders to lend to mortgage prisoners (and other borrowers). These interventions are the modified affordability assessment and the intra group switching rule.

2. Our findings show how complex this issue is. Regulatory changes can help remove one obstacle. But other, wider issues, including borrower or loan characteristics, are also barriers to switching. We have seen a moderate response from borrowers, and at the same time a lack of appetite from lenders to use the modified affordability assessment.

3. Our review found that the modified affordability assessment, or the alternative approach some lenders adopted of introducing limited exceptions to their standard underwriting approach, has been used as part of the process for enabling around 200 relevant borrowers to switch to a new deal. This is fewer than expected, and may be for a variety of reasons, including:

- Lenders have limited appetite to offer switching options to mortgage prisoners. At the time we collected data for our review around 5 lenders were providing switching options.
- Most of the small number of borrowers who applied to lenders had borrower and loan characteristics that do not meet lenders' credit risk appetites.
- Borrowers do not always engage with switching. For example, in response to 140,000 letters sent about potential switching options, the Money and Pensions Service (now known as MoneyHelper) received only 534 calls and mortgage intermediaries received 702 calls. (And there may have been some overlap between the calls to MoneyHelper and intermediaries.)

4. However, over 2,000 borrowers (previously in the closed book/inactive firm population) were able to switch to another lender without making use of the modified affordability assessment. Although we can't be certain (as we did not carry out any consumer research as part of the review) some of these borrowers might have been prompted to switch by our requirement that inactive firms contact customers about their options.

5. A small number of financial groups have both an active lender and a closed book that is in a different entity to the lender. Our review found that most, but not all, borrowers in this situation have, or will have access to new deals.

Our approach to the interventions review

6. The data that informed this review included:

- Data reported to us by firms through Product Sales Data that tells us if lenders used the modified assessment from Q2 2021. Some lenders have also helpfully retrospectively reported the use of the modified affordability assessment to include Q4 2020 onwards.

- Information from The Money and Pensions Service (MaPS), through their consumer facing brand MoneyHelper, on the use of their resources including their webpage, eligibility tool and a telephone helpline.
- Data reported by mortgage intermediaries (those on the MoneyHelper list) about borrowers who contacted them about switching options.
- Data from some mortgage administrators for unregulated entities on levels of redemptions. Redemption is the process of paying off the outstanding balance on the mortgage and any other fees associated with it.
- Information from a wide range of industry stakeholders to understand their experience of offering switching options under the modified affordability rules (as well as any decisions not to do so) or supporting borrowers to access these. These stakeholders included trade associations, 15 lenders (8 who were offering or planning to offer switching options and 7 lenders who were not) and a group of intermediaries, most of whom are members of our Implementation Group.
- Information from other key stakeholders, MoneyHelper, StepChange and other consumer groups that advocate for and support mortgage prisoners.

7. While a mortgage prisoner could be with an active lender or with an inactive firm, we estimate that almost all mortgage prisoners will be with an inactive firm. This is because active lenders covering 97% of the market have committed to enabling existing customers to switch to a new deal, where they meet certain criteria (eg are up to date with payments). Our analysis therefore focuses on the situation of borrowers with inactive firms, including mortgage prisoners.

How we intervened

8. Where a lender enters into a new contract with a borrower, we typically expect them to assess affordability. However, there is an exception to this where an existing borrower switches to a new product with the same lender, providing there is no additional borrowing or no change to the terms of the contract that is likely to be material to affordability. The modified affordability assessment and intra-group switching rules enable lenders to provide switching options for customers switching to a new lender, including where they switch to a new lender in a different legal entity within the same financial group.

Modified affordability assessment

9. In October 2019, we changed our rules to reduce the regulatory barriers to switching lenders by introducing a modified affordability assessment. These rule changes were intended to make it easier for lenders to lend to borrowers with inactive firms who are mortgage prisoners (as well as other borrowers).

10. The change enabled lenders to simplify their approach to assessing affordability for borrowers, who are up to date with their mortgage payments, and want to switch lender providing they meet certain conditions such as not looking to borrow more. Under this modified assessment, mortgage lenders can enter into a new mortgage contract with an eligible consumer if they can demonstrate that the new mortgage is more affordable than the present one. In carrying out this modified assessment, mortgage lenders do not have to apply some existing rules i.e. they do not need to apply the requirements to assess affordability based on a borrower's verified income and expenditure, they do not need to consider the effect of expected future interest rate rises and they do not need to check that a customer taking out an interest-only mortgage has a credible repayment strategy.

11. Each lender will make a commercial decision about whether or not they want to use the flexibility in these rules. The use of it will depend not only on a borrower's eligibility but on the lender's own risk appetite. This means that there is an inherent limit to how far the modified affordability assessment can help.

Expected impact of removing regulatory barriers

12. In the Consultation Paper (CP19/14, March 2019) that proposed the modified affordability assessment, we stated that there was considerable uncertainty about the number of eligible borrowers that would search for a new mortgage and be accepted by a lender. This was because we had limited information at the time about the loan and borrower characteristics of mortgages in closed books with unregulated entities. Also, we needed to make assumptions about the appetite of lenders to use the modified affordability assessment to provide switching options to consumers as well as the expected demand from, and behaviour of, eligible borrowers. Nevertheless, the cost benefit analysis (CBA) did set out some estimates of the potential level of switching as a result of these changes.

13. One estimate in the CBA was that between 2,000 and 14,000 borrowers would be able to switch to a better deal. In our Policy Statement, (PS19/27 October 2019), we noted that the estimate was likely to be closer to the lower end of this range (ie around 2,000).

14. After the publication of our Policy Statement introducing the modified affordability assessment, we collected data from firms to understand more about borrowers who had mortgages with unregulated entities to supplement our existing data on borrowers with inactive lenders.

15. In January 2020, we published new data which estimated that there were around 250,000 mortgages with inactive firms. 170,000 of these borrowers had been up to date with payments for at least 12 months and were eligible to switch because of our rule changes. We estimated that around 14,000 of these would:

- **likely meet the commercial risk appetite of lenders.** This was based on information from industry including information on lenders' decision-making process and the extent to which combinations of various loan and borrowers' characteristics were likely to meet lending criteria, **and**
- **would stand to make a meaningful saving from switching** i.e. this analysis excluded those that were on an interest rate of 3.5% or lower as we considered it unlikely that they would be able to switch to a lower rate given their loan and borrower characteristics. Borrowers that had mortgages that were small or close to ending were also excluded as they would also not make a meaningful saving from switching. In other words, we considered that some borrowers would not meet lender criteria and that others would not benefit from switching.

16. This resulted in an estimate that around 14,000 borrowers might be eligible to switch to a new deal using the modified assessment should they choose to.

17. Following the January 2020 publication, we have conducted further analysis on borrowers in closed books with inactive firms, based on more up-to-date data. We include the results of this analysis in this Review.

Reviewing the effect of the modified affordability assessment

18. We found that a limited number of borrowers have obtained a new deal using the modified affordability assessment (or through changes to firms' underwriting processes). Both lenders and mortgage intermediaries received small numbers of enquiries and applications, which resulted in around 200 completions.

Information from industry:

- Mortgage Intermediary data: Between December 2020 – September 2021 (see annex 5 for the full monthly breakdown):
  - Intermediaries received 702 calls from borrowers who called after using the MoneyHelper list of intermediaries
  - Intermediaries submitted 66 applications to lenders on behalf of these borrowers
  - These applications from intermediaries resulted in 26 mortgage offers
- Lender information: The majority of lenders received few enquiries and applications.
- PSD data on use of modified affordability assessment: Lenders reported 155 mortgage completions using the modified assessment in Q4 2020 to Q2 2021. Information from firms includes another 40-50 completions (not using the modified affordability assessment, but as a direct or indirect result of our changes).

Information from consumer groups:

- Of around 500 calls to the MoneyHelper dedicated mortgage prisoner phone service:
  - 70% of callers did not meet lenders' criteria (ie repayment mortgages with maximum 85% LTV, outstanding term of more than 5 years and an outstanding loan of more than £50,000)
- MoneyHelper had an agreement to refer relevant cases to StepChange:
  - StepChange spoke to around 160 borrowers, most were referred to them by MoneyHelper but others were referred by a firm.
  - StepChange found that they were unable to find a new deal for the vast majority of these borrowers with only 8 applications possible, and 6 borrowers moving to a better deal.

19. Based on engagement with firms and consumer representatives, we found 3 main reasons why borrowers have not switched. They are:

- Limited market appetite to offer switching options to mortgage prisoners
- Moderate levels of engagement by borrowers in this population
- Borrower and loan characteristics remain outside the credit risk appetites of lenders

Limited market appetite for offering switching options to mortgage prisoners

20. At the time of collecting data for our review around 5 lenders have provided switching options to mortgage prisoners using the modified assessment, or by introducing limited exceptions to their standard underwriting approach. Other lenders had planned to offer switching options, but their plans were delayed or stopped by the changes driven by the pandemic.

21. To understand firms' appetite to offer switching options, we spoke to 7 lenders who had not done so. They told us that there was insufficient incentive for lenders to offer switching options given the small pool of potential customers. The costly and time-consuming changes involved in setting up a separate process meant that introducing switching options for a relatively small number of potential customers may not be commercially viable.

22. Another issue raised by industry was that, given borrower and loan characteristics, it was difficult to price switching options at a rate that would be attractive to potential customers. Risk based pricing means that lenders charge higher prices where they consider the risk of default is higher.

23. An additional concern raised by industry was how complaints about such switching options would be dealt with by the Financial Ombudsman Service.

24. The Financial Ombudsman is operationally independent of the FCA and we cannot speculate on the likely approach of the Financial Ombudsman to potential complaints involving a firm's use of the modified affordability assessment. As with other complaints, the Financial Ombudsman will develop its approach through consideration of the complaints referred to it.

25. The Financial Ombudsman is required by FSMA to determine complaints by reference to what is, in its opinion, fair and reasonable in all the circumstances of the case. In doing so, it will, among other things, take into account all relevant FCA rules and guidance and the policy intention behind them.

Approaches to pricing using the modified affordability assessment

26. Some firms were concerned about the possibility of future liability if, in order to make the new mortgage "more affordable" and therefore to be able to lend to mortgage prisoners using the modified affordability assessment, they would have to offer better deals than those currently offered to otherwise comparable customers.

27. As we noted in PS19/27 when we brought in the modified affordability assessment, lending is a commercial decision. Lenders are able to choose whether, and when, to lend to eligible customers using the modified assessment. Nothing in the modified affordability assessment compels firms either to restrict the use of the approach to those that are mortgage prisoners or, conversely, to use the same underwriting approach for all prospective customers.

28. However, the discretion to use the modified affordability assessment must of course be used fairly. The Financial Ombudsman may consider the fairness of lending decisions, including decisions to use the modified affordability assessment.

Offering mortgages without a full affordability assessment

29. Some firms were concerned about future liability should they offer a customer a new mortgage contract without a full affordability assessment. They were concerned that the new contract, though cheaper, might leave the borrower exposed to potential harm (for example if the borrower is ultimately unable to fully repay the capital at the end of the mortgage term).

30. The Financial Ombudsman will take into account that the modified affordability assessment works by permitting lenders to disapply many of our responsible lending rules for eligible borrowers. This is because its purpose is to enable eligible borrowers who cannot otherwise switch to move to a more affordable mortgage. Our rules (MCOB 11.9) outline what we view as more affordable. Consumers must also be told the steps a firm has taken to ascertain that the new mortgage is more affordable and receive relevant additional disclosures about some potential risks associated with switching under the modified affordability assessment.

31. In addition, our selling standards and rules (in MCOB 4) mean that many, although not all, customers looking to remortgage with a new lender will get advice. Where customers are being advised, there will be as a matter of course an assessment regarding whether the new contract is appropriate to the needs and circumstances of the customer. A lender has an option of only making use of the modified affordability assessment where they know advice has been given in some or all circumstances.

32. Lenders need to act in line with our requirements to treat customers fairly. When assessing whether a customer has been treated fairly, the Financial Ombudsman will take into account their circumstances when a lender took them on- for example, if they were an interest-only customer who already lacked a credible repayment strategy at this point. The Financial Ombudsman will also consider whether the borrower's situation improved overall as a result of moving to the new lender. If the borrower has an interest-only mortgage and risks being unable to repay their loan upon maturity, the Financial Ombudsman would also consider whether the new lender acted in accordance with our relevant guidance (FG13/07).

Moderate levels of consumer engagement with switching

33. We found only a moderate level of consumer engagement.

Data on consumer engagement with switching options:

- Inactive lenders and administrators for unregulated entities sent out approximately **140,000 letters** to relevant eligible borrowers about potential switching options before the 15 January deadline.
- These letters typically directed borrowers (although they were not required to do so) towards a 'Help for mortgage prisoners' guide set up by Money and Pensions Service (MaPS) on their MoneyHelper website. The digital guide had **49,238 page views** and **36,220 visits** between September 2020 and May 2021. The digital guide has resources for borrowers including:
  - A **mortgage prisoner eligibility tool**: which helps borrowers find out whether or not they might be accepted by lenders. This tool was **downloaded 21,791 times** between October 2020 and May 2021.
  - A **mortgage prisoner phone service**, which received **534 calls** between October 2020 and May 2021 – 70% of consumers making these calls had loan or borrower characteristics that did not meet the standard modified mortgage affordability criteria.
  - A **list of around 300 mortgage intermediaries** who responded to a call for intermediaries willing to help these borrowers get a new deal. This list was **downloaded 7,284** times between October 2020 and May 2021 and intermediaries received 702 calls from borrowers between December 2020 and September 2021.

34. The moderate level of consumer engagement should be seen in the context of similar consumer communications that may not have high response rates.

35. Stakeholders suggested several reasons why many borrowers did not look to switch after the communications, such as:

- Borrowers thinking it unlikely they would find a cheaper deal than the one they're currently on.
- Borrowers lacking motivation to switch due to current, relatively low monthly payments, and the perceived time and effort involved in switching to a new deal – even where they could benefit overall from switching.
- Borrowers being reluctant or uncomfortable about discussing their finances – for example if their income or expenditure had changed since they took the mortgage out. The pandemic caused uncertainty and worry about finances which may understandably have made some borrowers less willing to engage during that time.
- The timings of the communications. Mailings were sent over a period covering both the pandemic and winter holidays and may have been less successful as borrowers may have had other priorities.
- The limited number of communications sent, typically only one letter.
- The format of the letters and quality of resources available for borrowers – for example the letters being generic rather than personalised.
- The large number of intermediaries to choose from.
- The fact that communications were sent by firms. Some suggested that consumer groups might have been more successful in securing more engagement and response if they had been contacting borrowers directly rather than firms leading on this.
- Difficulties understanding the communications. Some said that it was difficult for borrowers to find out what products were being offered by lenders to help them.

36. Some stakeholders also identified the possibility that intermediaries' ability to engage might have been affected by the pandemic and the active state of the market at the time, buoyed by the temporary stamp duty cut.

Consumer Experiences from MoneyHelper and StepChange

MoneyHelper

Borrowers who received one of the 140,000 letters sent by inactive lenders and administrators to relevant borrowers suggesting they might be able to switch to a new lender using the modified affordability assessment, were typically directed to the Money and Pensions Service via their MoneyHelper consumer brand.

MoneyHelper focused on delivering effective guidance and identifying what the next best step was for the borrower to help them improve their situation.

To support this campaign they provided digital guidance and an interactive 'eligibility' tool together with a mortgage intermediary list to help customers to explore their options.

It quickly became clear that many customers calling MoneyHelper needed additional guidance and support. MoneyHelper set up a telephony-based appointment service which provided a 45-minute slot for consumers to speak to an expert 'money guider' who could listen to the consumer's personal circumstances, understand their options and help them take the next best step to finding a solution. Specific focus was given to consumers at risk of losing their home.

Borrowers had a variety of personal and financial situations that affected their ability to effectively access the market:

- Many were elderly and/or in vulnerable circumstances,
- some were long term sick or disabled, and
- a high percentage had interest-only mortgages and were nearing the end of the term with no means of repaying the capital.

Some borrowers wanted to remove or add a borrower to their mortgage, others who had always been able to pay their mortgage were advised their income was too low to switch to a new mortgage, and others had impaired credit. For many who were ineligible to switch, the loan to value ratio was too high as they lived in areas of the UK where there had been little or no house price inflation.

MoneyHelper noted the wide variety of circumstances and reported that people valued the personalised service and support tailored to their personal circumstances.

StepChange

StepChange Financial Solutions (a subsidiary of the charity providing regulated mortgage and equity release advice) submitted an expression of interest to join the list of mortgage intermediaries willing to help mortgage prisoners. The client referrals that followed from the borrower communication strategy are summarised below.

As at 22 October 2021 StepChange had received a total of 166 client referrals. 83% were referred by MoneyHelper. 10% of referrals came from an administrator. The great majority (80%) of borrowers referred to StepChange had an interest-only mortgage. 18% had a repayment mortgage and 2% had a part repayment and part interest-only mortgage.

StepChange were unable to contact 14% of borrowers referred to them, despite attempting to contact them on three occasions. This may have indicated that the customer journey was not as effective as it could have been.

Of the 166 enquiries, 31% of the borrowers StepChange spoke to did not meet lender criteria. 10% had adverse credit histories and/or scores. They were able to proceed to a 'fact find' for 41 clients (25% of all referrals). StepChange were only able to recommend a mortgage product for 14 clients, with 8 moving to an application.

Only 6 people from the 166 referrals managed to switch to a better deal (less than 4%).

Borrowers seeking to switch outside lenders' credit risk appetites

37. Industry told us that the small number of borrowers who did engage with lenders and intermediaries about switching were generally not able to get a new deal, primarily because they had a combination of circumstances that placed them outside of lenders' risk appetites. Reasons for declined applications included:

- The borrower applied for an interest-only mortgage with no or insufficient plans to repay the capital borrowed. StepChange also told us that 80% of the borrowers they spoke to had interest-only mortgages, and most of these borrowers had no plan to repay the capital at the end of the mortgage term.
- The borrower's income was considered insufficient to sustain the mortgage payments longer term. For example, their incomes were too low or they had non-standard incomes.
- Borrowers were over-indebted or had an impaired credit history. Intermediaries said they signposted some borrowers to debt advice.
- The loan to value (LTV) of the mortgage was too high.
- Borrowers were near/in retirement with insufficient income in retirement to support a new loan.

38. These issues were also seen in the UK Mortgage Prisoner Action Group survey of a small sample size of 188 respondents in their Facebook group in August 2021. This found that, of the 142 respondents who had tried to remortgage, 75% had been refused, with the main reasons being lack of affordability (38%), their credit history (25%), other debt (11%) and LTV (8%).

39. Other less common issues raised with us by industry included borrowers having buy-to-let properties or non-standard properties on which some lenders do not offer mortgages.

40. In a few cases, industry stated that the borrower wanted to add or remove another borrower from the mortgage contract. In some circumstances, this may be possible under our rules. But lenders who have chosen to offer switching options, by amending their existing processes rather than adopting the modified affordability assessment, are likely to be more restricted in their ability to offer a new deal to borrowers wanting this transfer of equity. This is because of the potentially material impact of this change on affordability.

41. Industry did consider whether other home finance options such as equity release and retirement interest-only mortgages (RIOs) might be appropriate. StepChange reported that the borrowers they spoke to were unlikely to meet the lender criteria for equity release as some were not old enough or did not have enough equity in their property.

RIOs for mortgage prisoners?

Some industry stakeholders suggested our standard affordability rules can prevent some joint borrowers from getting RIOs. In such cases our guidance expects firms, when assessing the affordability of a RIO, to assess the ability of a single borrower to continue making the required payments if the other borrower dies. A lender and a trade association suggested that we modify this guidance e.g. by allowing lenders to offer RIOs if they are satisfied the property would provide sufficient equity for the remaining borrower to downsize in the event of the other borrower's death.

We have considered this, but would be concerned about any changes to our requirements that could result in older borrowers losing their home if they are unable to make repayments when their partner passes away.

42. The case study below shows some of the difficulties borrowers faced.

MoneyHelper case study 1: A borrower who cannot switch due to having an interest-only mortgage with no means to repay the capital, a high LTV and low income
This borrower took out a capital repayment mortgage in 2004. However, they needed to switch to an interest-only mortgage (without a repayment plan in place) in 2007 due to a change in their personal circumstances. When they spoke to MoneyHelper, their mortgage had an LTV above 75%. They are likely to struggle to switch back to a repayment mortgage because their income will not cover the higher monthly payment, or to another interest-only loan as they have no means to repay the capital and a high LTV.

The impact of prudential regulation on solutions for mortgage prisoners

43. While the focus on removing regulatory barriers has primarily been on conduct regulation, our discussions with firms have also touched on their concern regarding the impact of prudential regulation on Banks and Building Societies in terms of firms having to hold more capital against riskier loans. One area where this creates a particular tension is interest-only lending where the customer can provide no evidence of a credible repayment strategy.

44. Under the UK Capital Requirements Regulation the Prudential Regulation Authority has confirmed that if an interest-only mortgage is not repaid after a period of either 90 or 180 days at the end of the term it has to be treated as a loan in default and the firm has to hold more provisions or capital against the loan. These rules are not discretionary and cannot be waived. Because of this additional cost, which makes lending more expensive, lenders may well be unwilling to take on borrowers with interest-only mortgages with high LTVs and no repayment plan. In cases where interest-only remortgage products are available the interest rates charged are therefore likely to be substantially higher than would otherwise be the case.

Where borrowers with inactive firms did find a new deal

45. Other borrowers with mortgages in closed books with inactive firms have been able to switch using the new options available.

Case study 2 – single borrower
This borrower had a repayment mortgage with an inactive firm with a relatively low LTV of just below 40% and a remaining term of more than 20 years. They were able to switch to a new 5-year fixed rate deal at a lower rate of interest (under 2%) than their previous rate under a lender's switching option for mortgage prisoners. This borrower was previously paying an interest rate of around 5% and therefore their monthly payment has reduced significantly to under £400 on the new deal.

Case study 3 – joint borrowers
These joint borrowers had a repayment mortgage with an inactive firm. Their mortgage had a remaining term of a little under 10 years and a very low LTV. They were able to switch to a new 5-year deal under this lender's switching option at a fixed interest rate of under 1.5%. This reduced their monthly payments from around £400 to under £350.

46. In addition, some borrowers with inactive firms can get (and have got) a new deal under lenders' standard processes. This underlines that not all borrowers with inactive firms are 'prisoners', some can switch. As we noted in Annex 1, we looked at the mortgage accounts in our closed book population which were reported as closed during H1 2021 to see whether these borrowers were remortgagng to other lenders in our sales data covering the same period (H1 2021). Of 20,486 accounts reported as being closed in H1 2021, we found that over 2,000 (10%) had switched to a new lender.

47. To explore whether borrowers with inactive firms were more likely to have switched lender after the change to our rules, after new switching options became available and following the required mailings, we obtained information from some administrators on redemptions data relating to the books they administer for unregulated entities. We wanted to understand whether some borrowers may have been prompted to switch to a new deal but may not have needed to apply using the modified affordability rules. Findings from this were mixed – while one administrator reported that there was no material impact, 2 of the administrators we spoke to said they had seen an increase in redemptions after the required mailings.

48. We cannot say whether this increase in redemptions is the result of more borrowers being prompted to switch by the required mailings. There may be other reasons for the increase, such as customers moving home or otherwise redeeming their mortgages. However, it is possible there was an increase in switching by borrowers in this population because of the mailings.

49. In summary our findings show how complex this issue is. Regulatory changes can help remove one obstacle. But other, wider issues, including borrower or loan characteristics, are also barriers to switching.

Reviewing the effect of the intra-group switching rule change

50. The intra-group switching rule, which came into force in October 2020, extended the ability of lenders (subject to certain conditions) to offer a new deal to existing customers without assessing affordability. The rule change allows this same flexibility where closed book borrowers of one legal entity are entering into a new contract with a different lender from the same financial group. It remains a commercial decision for each lender as to whether they want to use this flexibility.

Expected impact of removing regulatory barriers

51. In our cost benefit analysis for the rule change we estimated that there might be 63,000 mortgages in closed books where there was an active lender in the wider financial group. We estimated that 25,000 of these would potentially benefit from the rule change.

52. We now know this was an over-estimate as some firms were already offering borrowers switching options prior to the new rule and therefore did not need the change.

53. As we noted when making the intra-group change, securitisation and the precise ownership arrangements of the mortgages will impact on the applicability and use of the new rule. Where we think this is the case, we have added borrowers with affected mortgages into the closed book population.

Lenders' use of the intra-group switching rule and other options to benefit borrowers

54. A small number of financial groups have both an active lender and a closed book that is in a different entity to the lender. We engaged with a number of these firms to find out whether or not they had used, or planned to use, the intra-group switching rule. We also asked if they had taken any other steps to help borrowers in closed books.

55. The rule change has been welcomed by these lenders, trade bodies and consumer groups. At least one lender has made use of the rule since it came into force. Other lenders say they either intend to (or may) make use of the rule in the future.

56. From our engagement with firms, we understand that most, but not all, borrowers in closed books where there was an active lender in the wider financial group have, or will have, access to new deals.

Communication strategies

57. Firms looking to offer options to borrowers in closed books told us they had found low levels of engagement from borrowers. As the review did not include consumer research to explore the reasons for the low engagement, we cannot be certain of the reasons for this.

58. In summary, the intra-group rule change appears to have had a positive impact (whether directly or indirectly). The rule change has removed a regulatory barrier to allow some borrowers to switch their mortgage from a closed book to an active lender within the same financial group.

Annex 4
Background and wider context

The wider context

1. We want the mortgage lending market to provide good outcomes for all customers and to enable choice and competition. We found in our Mortgages Market Study (MMS) that competition is working in the mainstream market, switching levels are high, there are a range of products on offer and apparent competition on headline rates between lenders. The MMS found that borrowers benefit both from being able to get a new better deal from their current lender (internal switching) or from a new lender (external switching). But some borrowers can't switch. We call borrowers who are up to date with payments and cannot switch, but who could benefit from switching depending on their loan and borrower characteristics, mortgage prisoners.

2. Borrowers can find they are unable to switch to a new mortgage deal because their circumstances have changed since they took out their mortgage or last switched, perhaps because of a significant life event such as losing their job. But, most of the difficulties in switching facing mortgage prisoners can be traced back to the major changes to lending practices during and immediately after the 2008 financial crisis, and the subsequent regulatory response aimed at preventing a return to past poor practices (eg self-certification of income). Some firms exited the market or ceased to write new mortgages, and many firms approached new lending with reduced risk appetites. Reduced risk appetites were partly a response to lenders' own risk decisions and partly a response to regulatory change to ensure lenders provided affordable mortgages and to reduce the likelihood and impact of lenders failing.

3. Mortgage prisoners are most likely to have a mortgage in a closed book with an inactive firm (rather than with an active lender) because many of the mortgages taken out pre-crisis (in 2008 or earlier) are in these books and these firms do not offer new deals to existing borrowers.

4. This chapter explains the background to the mortgage prisoner issue and the work we have done to help these borrowers. It also sets out how our new analysis differs from the analysis in our July 2020 Statement on Mortgage Prisoners.

History of specialist lending and characteristics of the closed books with inactive firms

5. In the years preceding the financial crisis, surplus mortgage funding (caused by a buoyant securitisation market) contributed to the growth of a more specialist lending sector and the availability of mortgages for borrowers with higher risk characteristics.

6. Specialist lending is best described as lending to a segment of the market not served by mainstream lending solutions. In the pre-crisis years particularly between

2005-2007 specialist lending almost became mainstream with lenders competing for business not only on price but also on lending criteria.

7. Products were designed to meet a wide range of non-mainstream circumstances. This included 100% mortgages, mortgages for the credit-impaired and without income verification. Borrowers could also take out interest only mortgages without a supporting repayment vehicle and borrow against properties that were of a 'non-standard construction'.

8. Sub-prime products were typically categorised as light, medium and heavy adverse with heavy adverse products targeted at borrowers who were already in financial difficulty, for example in serious arrears and/or with County Court Judgements (CCJs) - and who also needed to self-certify their incomes to obtain mortgages on an interest only basis. Many specialist non-bank lenders active in the sub-prime market offered Bank base rate and LIBOR linked trackers. The interest rate loading (above Bank base rate or LIBOR) reflected pricing for risk and products typically tracked 1% to 4% above base/LIBOR.

9. While this extended home ownership to those who may previously have struggled to access it, it also increased market risks where the product features and lack of robust affordability checks allowed consumers to take on mortgages that may have caused them to be over-stretched.

10. Although non-bank lenders are typically seen as the primary actors in this sector, other mainstream lenders (some banks and building societies) also offered mortgages without verifying income (self-certified, non-verified, fast-tracked) as well as interest only mortgages through subsidiary firms. Some lenders, or their subsidiaries, also bought mortgage books from specialist sub-prime lenders.

11. The onset of the financial crisis and the virtual closure of the securitisation markets meant that most lenders active in the specialist sub-prime sector reliant on securitisation to fund their mortgages either exited the market or ceased lending. Specialist subsidiaries of banks and building societies closed to new business and in the event of the failure of the entire firm, were sold. Some of the books of lenders who had left the market were also sold, sometimes to unregulated firms post-nationalisation.

Together Mortgages

12. A number of borrowers who currently have a mortgage in a closed book with an inactive firm took out a product called the Together Mortgage before 2008. This product, offered by Northern Rock, allowed borrowers to take out a 95% mortgage and a linked unsecured loan of up to 30% of the value of the property on the same terms as the mortgage. It effectively allowed those with little or no deposit to access homeownership and provided additional funds. The product could also be taken out on an interest-only basis.

13. The performance of these loans relative to standard mortgages has been poor. A House of Commons Public Accounts Committee report – The Nationalisation of Northern Rock published in June 2009, said

'As at 31 December 2008, Together mortgages represented around 30% of the mortgage book, but about 50% of overall arrears and 75% of repossessions'

14. A feature of the Together Loan is that the interest rate on the unsecured loan was set at the same rate as the main mortgage but this only applies if the mortgage and loan account remain linked. The precise terms and conditions varied depending on the year the loan was taken out. For Together mortgages taken out in later years, the rate on the unsecured loan increases by a maximum of 8% i.e. SVR + 8% if it is de-linked from the secured loan.

15. Borrowers with Together mortgages on a repayment basis who are up-to-date with payments may have more scope to consolidate the unsecured element into a new mortgage, but this may be more difficult for interest-only borrowers unless they have benefitted from significant growth in property values and have a credible strategy to repay the capital.

What we have done to help mortgage prisoners

16. At the time of the Mortgage Market Review (MMR), the Financial Services Authority (FSA) recognised that the introduction of more rigorous responsible lending rules would impact on mortgage availability for some borrowers. It assessed this would be to a much lesser degree than the revised lender appetite at that time. The FSA published a Cost Benefit Analysis for the MMR responsible lending proposals in CP11/31. The greater conservatism of lenders was noted as impacting on those with past credit problems or those who had interest-only loans. The Mortgage Market Review Data Pack that accompanied the final MMR rules explored these borrower characteristics in more detail.

17. Because of this the FSA put in place 'transitional' arrangements' in MCOB 11.7 to help existing borrowers. These were designed specifically to mitigate the impact on existing borrowers who either:

- were unable to demonstrate affordability for their new mortgage as required by the new affordability requirements; or
- did not have an acceptable repayment strategy for an interest-only mortgage in place and were unable to demonstrate affordability on a capital and interest basis.

18. The transitional arrangements were equally available to existing and new lenders but did not compel the lender to lend, even where the borrower met relevant conditions. Subsequently the UK's implementation of the Mortgage Credit Directive removed the ability of new lenders to take on borrowers from other firms without having to assess affordability. We noted in paragraph 2.11 of PS15/9 when making this change that in practice lenders had made extremely limited use of the flexibility to take on other lenders' customers without assessing affordability.

19. Our rules continued to allow lenders to offer new deals to their existing customers without undertaking an affordability assessment, providing certain conditions were met such as there is being no additional borrowing other than to finance product or arrangement fees.

The Mortgages Market Study

20. The MMS estimated that there were 30,000 mortgage prisoners with active lenders who would benefit from switching but had not been offered new internal deals and who could not switch to another lender. Following this we worked with industry, who delivered a voluntary commitment supported by the vast majority of active lenders to offer a new deal to existing customers where they met agreed criteria (for example not being in arrears). This means there are likely to be fewer borrowers who have a mortgage with an active lender who cannot obtain a new deal.

21. The MMS also indicated there could be further mortgage prisoners who had mortgages with regulated lenders who are not lending to new customers (inactive lenders with closed books) and unregulated entities. We refer to these collectively as inactive firms. Customers of inactive firms generally have no internal switching options and so can only access new deals by remortgaging to an active lender if they can find a lender willing to lend to them and at a price that makes switching worthwhile. The MMS was unable to estimate the number of mortgage prisoners in closed books with inactive firms due to a lack of data. It is this population that is the focus of the data analysis in this Review.

The modified affordability assessment and intra-group switching rules

22. In October 2019, we changed our rules to reduce the regulatory barriers to switching by introducing a modified affordability assessment. In October 2020 we also made it easier for an active lender to offer new deals to closed book borrowers in a different legal entity within the same financial group. Lenders do not have to make use of the flexibility offered by our rules and we summarise the effect of these rule changes in Annex 3.

23. In support of the modified affordability assessment we published, in January 2020, a Summary of mortgages in closed books with inactive firms. This used data we collected from administrators of inactive firms in September 2019, to supplement data reported to us by authorised firms. This indicated there were around 250,000 mortgages in closed books with inactive firms. In July 2020, we published a Statement on mortgage prisoners which provided further analysis.

Support during the coronavirus pandemic

24. We recognised that the pandemic has been an uncertain and difficult time for borrowers. We wrote to a number of firms concerning the fair treatment of customers who are paying variable rates on mortgage contracts (with higher risk characteristics taken out before the financial crisis). We were clear that lenders should actively review their rates. In respect of firms administering books on behalf of lenders, we reminded them of their obligation to treat customers fairly where they have discretion to set rates.

Support for those in payment difficulty

25. Borrowers who are not up to date with payments, whether they have a mortgage with an active or inactive lender, are unlikely to be able to switch to a new deal as lenders do not normally lend to those already in payment shortfall. Where a borrower is not up to date with their payments, we expect firms to treat them fairly and provide appropriate support which takes account of any characteristics of vulnerability. Firms, including those who administer mortgages owned by unregulated entities, should consider a range of appropriate forbearance and repayment options with borrowers and only seek repossession as a last resort.

26. During the pandemic we acted quickly to protect mortgage borrowers during this difficult time. We issued guidance to firms that borrowers who were facing or reasonably expected to face financial difficulty due to coronavirus should be able to access payment deferrals. Lenders confirmed that their existing customers who have taken payment deferrals under our guidance would still be able to access new deals under the voluntary agreement providing they were otherwise up-to-date with payments. Our Tailored support guidance sets out our expectations that firms continue to provide appropriate support to borrowers who still face payment difficulty as a result of coronavirus - and we are actively supervising firms' delivery of this.

Support for those with maturing interest-only mortgages

27. We issued guidance on maturing interest-only and part-and-part mortgages in PS20/11. This came into force on 31 October 2020. The guidance stated that firms should allow eligible borrowers, including those in closed books with inactive firms, with an interest-only or part-and-part mortgage due to mature between 20 March 2020 and 31 October 2021 to delay repayment of their capital until 31 October 2021. This was subject to being up to date with their payments and maintaining their monthly interest payment. The guidance was a short-to-medium term measure to provide support to borrowers whose repayment strategy may have been affected by the pandemic. The guidance expired on 31 October 2021.

28. More broadly we expect firms to treat those with interest-only mortgages fairly. Our guidance FG13/07 sets out what we expect firms to do to ensure the fair treatment of customers who are unable to repay the capital sum at the end of the term, and to minimise the risk of non-repayment through early and effective engagement with customers.

29. We use a range of tools to monitor and regulate the UK mortgage market. Our Approach to Supervision sets out how we supervise firms, both lenders and regulated administrators. We supervise against a framework of principles and rules that represent minimum standards of conduct. The firms that we regulate, and their people are responsible for ensuring that they act in accordance with our principles and rules. We expect firms and their employees to meet these standards and hold them to account when they fail to meet them.

How this analysis compares to the analysis in our July 2020 statement

30. The MMS prompted changes to the data we collect and the analysis in this Review uses data for 2021 H1 which for the first time includes transactional level data on mortgages in closed books with inactive firms. The analysis in the Report updates our assumptions and our estimates of the numbers of different groups of borrowers and mortgages in the inactive firm population.

31. We can see that the number of mortgages in closed books with inactive firms has reduced since 2019 from around 250,000 to 195,000. The difference is primarily due to account closures. 20,486 mortgages were closed in the first half of 2021 with over 2,000 of these switching to a mortgage with an active lender (we do not have data on closures prior to this). As these books are closed to new business the number of borrowers in closed books will continue to reduce as mortgage terms come to an end or borrowers move home or switch their mortgage to an active lender.

32. The analysis in Annex 2 of this report considers the extent to which borrowers in closed books with inactive firms may or may not be able to switch and uses updated assumptions. For example, we report a much lower number of customers who are in payment shortfall as of June 2021, compared to the 2020 report. This is partly because the July 2020 report included those in shortfall in the previous 12 months (as it was assessing the number who would be eligible for the modified affordability assessment). Partly as a result of this, the number of mortgages up to date with payments but assessed as unable to switch has risen from 55,000 to 77,000, and the number of mortgages that meet our definition of a mortgage prisoner has therefore also risen, from 30,000 to 47,000.

33. The number of mortgages in closed books with inactive firms is reducing. This means that the number of mortgage prisoners as a percentage of the closed book population is increasing as many of those who can repay or switch their mortgage do so.

34. We do not have all the information a lender will want to know about a customer's circumstances when considering whether or not to lend. Our estimates of the number of mortgages whose borrowers have characteristics that suggest they are able or unable to switch in the open market, and of the number of mortgage prisoners, are limited by this. Different stakeholders also have different views on the definition of a mortgage prisoner and so we discuss our assumptions in this paper as well as the extent to which the estimated number of prisoners changes if we change those assumptions.

35. Annex 1 also provides a factual summary of what we know about the borrower and loan characteristics of the wider population of mortgages in closed books with inactive firms. This will enable stakeholders to use the data in different ways to consider and inform potential solutions to help more borrowers, including mortgage prisoners, switch to a better deal.

Annex 5
Monthly breakdown of data results from mortgage intermediaries

	Number of calls to brokers from borrowers after they had used the Money and Pensions Service intermediary list	Number of applications submitted to lenders	Number of mortgage applications that resulted in a mortgage offer	Number of borrowers who were referred to another intermediary specialising in debt consolidation or later life options	Number of borrowers who were signposted to other solutions, which may include debt advice
December 2020	257	11	3	4	26
January 2021	124	15	3	2	4
February 2021	111	10	4	3	6
March 2021	64	6	3	0	2
April 2021	39	4	2	0	4
May 2021	28	3	3	0	3
June 2021	19	3	2	0	0
July 2021	30	6	1	0	1
August 2021	16	3	3	0	0
September 2021	14	5	2	0	0
Total	**702**	**66**	**26**	**9**	**46**

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