FCA FINANCIAL CONDUCT AUTHORITY

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Dear CEO

FCA strategy for the Non-Bank (Mortgage) Lenders (NBLs) portfolio

The last 2 years have been extremely challenging for consumers, firms and businesses. The pandemic saw an increased level of engagement with our firms in addition to the ongoing projects that some NBLs were a part of. We recognise the pressure that was put on firms by the external environment and also how firms reacted, implementing the Tailored Support Guidance and acting quickly to build their capacity. This provided support to consumers who were able to get temporary support and forbearance when they needed it.

In this new environment, the FCA is transforming so that we can respond rapidly and effectively to the rapid changes we see in the markets we regulate, including innovation, digitalisation, and changing consumer needs.

We are becoming more innovative, making greater and more effective use of data and technology so that we can act more quickly and decisively. We are becoming more assertive - making full use of our powers, helping others to use theirs, and playing our part in tackling issues that don't sit neatly within our regulatory perimeter. We are becoming more adaptive, building on our response to the pandemic and changing our approach more quickly as the world changes around us – for example, quickly publishing guidance which led to 1.8m mortgages having payments deferred during the pandemic. We will report publicly on progress, being clear on what outcomes matter and what metrics we use to measure them.

Going forward, with the end of furlough schemes and the possibility of interest rates rising further, there is a risk that borrowers may find themselves in new or ongoing financial stress. We will need to continue to work together to ensure appropriate forbearance and fair treatment is provided to customers. And we must not lose sight of other risks of harm, such as the need to support consumers with maturing interest-only mortgages.

Purpose of this letter

We group firms in portfolios based on broadly similar business models. Your firm sits in the NBL portfolio, which is characterised by firms that do not take deposits and offer regulated mortgage contracts and/or regulated bridging loans.

Our focus for NBLs over the last 2 years was dominated by payment deferrals, coronavirus related forbearance and operational and financial resilience as a result of the pandemic. This was a diversion from our original strategy.

This letter is forward looking and sets out:

- Our views on the key risks of harm for NBLs' mortgage customers over the next 2 years
- Our expectations about what NBLs should consider when mitigating the key risks for these customers
- An update on FCA work relating to mortgage prisoners, our environmental, social and governance (ESG) strategy and Brexit.
- Our FCA regulatory strategy

Our key risks of harm and expectations have been developed alongside our other mortgage portfolios to ensure a holistic and consistent approach across the FCA.

You and your Board should carefully consider the degree to which your business presents these key risks of harm and review your strategies for mitigating them. You should be prepared to demonstrate how you and your Senior Managers are taking reasonable steps to address these risks and we expect you to promptly remediate newly identified issues.

Key risks of harm to customers and our expectations

1. Supporting mortgage customers in financial difficulty

The ending of temporary support measures (such as furlough and the Universal Credit uplift), inflation and rising interest rates may result in more people falling into financial difficulty over the coming months.

We believe the Tailored Support Guidance (TSG) and the findings set out in our March publication continue to provide an appropriate framework for NBLs to support these customers. The TSG is designed to enable firms to deliver short and long-term support to customers affected by the pandemic, treat them fairly and to help them get back to a more stable financial position. We want firms to deliver the following outcomes:

- Customers receive appropriate forbearance that is in their interests and takes account of their individual circumstances
- Firms support their customers through a period of payment difficulties and uncertainty, including by considering their other debts and essential living costs
- Firms recognise the characteristics of vulnerability and respond to customers' particular needs
- Firms have systems, processes and adequately trained staff, with any staff incentives aligned with providing customers with the help they need
- Customers receive the support they need in managing their finances, including through self-help and money guidance. Firms signpost or refer them to debt advice if appropriate

NBLs should consider the entirety of the TSG and our corresponding Handbook rules and guidance to demonstrate compliance.

We expect NBLs to provide their customers with the support they need when they get into financial difficulty, because of the pandemic or otherwise.

2. Managing maturing interest–only (IO) mortgages

There are approximately 1.42m full IO and part capital repayment mortgage accounts outstanding in the UK and over the next few years increasing numbers will require repayment, with a peak forecast in 2032. So, it is particularly important that NBLs employ a communication strategy that gives customers enough time to act where there is doubt about their ability to repay their IO mortgage. This will help customers have a better understanding of their situation, responsibilities, and options.

The potential harm to IO borrowers without repayment plans, some of whom may be customers in vulnerable circumstances, will continue to crystalise in the next decade. We expect NBLs to have robust governance arrangements in place. This could include a written strategy, consideration of what options can be offered to customers, providing guidance to, and monitoring frontline staff and collating management information.

3. Responsible lending

A failure to ensure responsible lending will always be a key risk of harm. As mentioned earlier there are some factors, such as rising interest rates, that may put additional strain on customers' disposable income in the coming months and years. So, where NBLs are required to conduct affordability assessments, this remains important to get right. NBLs should not be seeking to increase mortgage business volumes by lowering the stringency of affordability checks.

As the population ages, demand for later life lending is increasing and we expect NBLs, who operate in this market, to continue to take a prudent and proportionate approach to assessing customers' income beyond retirement.

We will actively monitor the market for outliers, and where necessary, look closer at lending decisions.

4. Libor transition

Panel Bank LIBOR ceased at the end of 2021 and any firm with LIBOR-linked contracts should, where practicable, have transitioned customers to a fair replacement rate. Where NBLs have contracts that will rely on 'synthetic' LIBOR after end-2021, they should continue their transition efforts as synthetic LIBOR will not be published indefinitely.

5. Adequate financial resources

Due to the funding model of NBL firms, the pandemic has highlighted the importance for all firms in this portfolio to have adequate financial resources in place. Certain factors, such as rising interest rates may cause arrears rates to rise and increase the risk of firm failures. Our expectation is that NBL firms should proactively monitor their prudential position, take necessary steps to ensure they are meeting Threshold Conditions and notify us promptly when experiencing difficulties. The starting point for this for firms that undertake home financing business is Chapter 4, Capital resources, of our Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance intermediaries (MIPRU). NBL firms should pay particular attention to MIPRU 4.2D on liquidity resources requirements, including stress testing and contingency funding plans. Further guidance is also found in FG20/21, Assessing adequate financial resources.

All firms should also maintain adequate wind-down plans which have been reviewed and approved by their Boards and which are kept up to date. The firm should incorporate the quantum of liquidity required to successfully complete a wind-down into its liquidity risk management framework, and consider how it will ensure liquid resources remain available at the point of wind-down. Please see the Wind-down Planning Guide for further information.

6. Treating customers in vulnerable circumstances fairly (to be considered across all risks of harm)

Our Guidance on the fair treatment of vulnerable customers is clear that to comply with our Principles for Businesses, NBLs should embed the fair treatment of customers in vulnerable circumstances in their business models, culture, policies and processes. Senior managers should create and maintain a culture that enables and supports staff to take responsibility for reducing the potential for harm to customers with characteristics of vulnerability. NBLs should be able to evidence to us how they are monitoring outcomes for customers in vulnerable circumstances and what changes they are making because of their monitoring, to improve outcomes for these customers.

7. Improving diversity & inclusion (to be considered in all activities)

We expect NBLs to understand the needs of their customers and be able to respond to them when designing products and services, providing flexible customer service and communicating with them. Having staff and Board members from diverse backgrounds and experiences contributes to this. Diversity & inclusion in regulated firms is a priority for us. DP21/2 (which closed on 30 September 2021), and the accompanying Literature Review, started the conversation on what more can be done to improve diversity & inclusion in financial services and set out the links between diversity & inclusion and conduct risks.

Update: Helping mortgage prisoners

We understand the difficult circumstances that mortgage prisoners are in. That's why the Government asked us to provide data to help them consider whether there are practical and proportionate solutions to help these borrowers. Our Review provides this data. It sets out the loan and borrower characteristics of the wider population of 195,000 mortgages in closed books with inactive firms.

We hope that more mortgage prisoners will be able to switch their mortgage. We encourage NBLs to consider if they can amend their lending criteria to lend to mortgage prisoners who are close to their risk appetite. We have published data so lenders can consider whether they can adapt their lending criteria (or use the flexibility in our rules) to lend to these borrowers.

Update: Borrowers in difficulties recovering from arrears

Our NBL Portfolio letter of January 2020 highlighted we had found examples of harm where customers were unable to recover from their arrears position and their mortgage debt continued to increase. This was observed where customers were on high interest rates, such as in parts of the second charge market. We confirmed our expectation that firms maintain adequate oversight of their arrears practices and take steps to ensure that customers, including particularly those who may be vulnerable, do not experience these harms. We remain interested in firms' actions to help customers recover from their arrears position and how the second charge market more broadly is delivering good outcomes for mortgage borrowers.

Update: Environmental, Social and Governance (ESG) strategy

Financial services and markets have a central role in the transition to a low carbon economy and a more sustainable future. The Government has committed to achieving a net zero economy by 2050. We will support the financial sector in driving positive change, including the transition to net zero.

We expect NBLs to play their part in helping the economy adapt to a more sustainable long-term future. We've seen encouraging steps taken by some NBLs, for example, providing green mortgages. But ultimately, a firm's own governance and culture will be critical drivers and enablers of its performance on environmental and climate matters.

Since wider environmental and social matters are increasingly central to economic and financial decision making, our work too must encompass ESG considerations beyond climate change.

Diversity and inclusion (as mentioned earlier) is a key component of ESG – both in its own right, and as an enabler of creative solutions to other environmental and social challenges. Building from our work so far, we have developed a refreshed ESG strategy. It sets out our target outcomes and the actions we expect to take to deliver these in the coming months.

Update: The Temporary Transitional Powers (TPP) are ending soon

To prepare for the end of the Brexit Transition Period, we onshored, and where necessary adapted, EU legislation to ensure it was workable in a UK-only context. Some requirements on firms and other regulated persons changed at the end of the Transition Period and, to avoid disruption, we used our Temporary Transitional Power (TTP) to give firms time to adapt to the new regime. With the end of the TTP fast approaching, we expect firms to be fully compliant with onshored regulatory obligations by 31 March 2022. For more information visit our Brexit website.

Our FCA regulatory strategy

Our Approach to Supervision (published in April 2019) sets out the purpose of, and our approach to, supervising firms and individuals. This builds on Our Mission, explaining how we currently supervise around 50,000 firms serving retail and wholesale customers.

We are proposing to introduce a new 'Consumer Duty', that would set higher expectations for the standard of care that firms provide to consumers. We consulted on specific rules and guidance in a second consultation paper. The consultation closes midnight tonight.

Our work on diversity and inclusion continues. We shall be consulting on rules and guidance to promote diversity and inclusion in the financial services sector in 2022.

NBLs should already be embedding the fair treatment of customers in vulnerable circumstances in their business models, culture, policies and processes. We will continue to ask about this during our supervision of NBLs.

As mentioned earlier, it is of great importance to the FCA that NBLs treat borrowers in financial difficulty fairly. In our Business Plan we said that we would look at how firms provide tailored support to borrowers and tackle the areas of greatest harm. We are currently working with a number of firms, including some NBLs, assessing whether they are supporting their customers in line with our guidance and whether outcomes are fair and sustainable. You can read our initial findings here.

Underlying our approach to consumer protection and competition, across all retail markets, is an increased focus on consumer outcomes and needs, particularly for those in vulnerable circumstances. Where firms are not meeting our expectations, we will act.

Next steps

All firms in the financial services industry are expected to conduct their activities in a way that treats consumers fairly, provides clear communications to consumers, resolves disputes and complaints fairly, and that complies with FCA Principles and FCA Handbook rules and guidance. We expect you to reflect on the issues highlighted in this letter to challenge how your firm operates.

Contact

If you have any questions please contact us on 0300 500 0597. This is the primary point of contact for your firm's day-to-day interactions with the FCA, and further details of how we can be reached are on our website.

In 2024 we will write again with an updated view of the key risks in the portfolio and our supervisory plans for the next cycle.

Yours faithfully

Brian Corr
Director of Retail Lending (Interim),
Supervision, Policy & Competition Division