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Dear CEO

FCA strategy for the Retail Mortgage Lenders (RMLs) portfolio

The last 2 years have been extremely challenging for consumers, firms and businesses. The response to the pandemic so far has shown the FCA and firms working well together to give consumers security and protection in the face of sudden instability and uncertainty.

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, the implications of the pandemic are likely to remain a significant influence on the work of both firms and the regulator, particularly helping those in financial difficulty. We will continue to monitor how firms provide tailored support and tackle areas of greatest harm. But we must not lose sight of other risks of harm, such as the need to support customers with maturing interest-only mortgages. This letter outlines our current thinking on risks of harm, our expectations, some updates and our strategy.

Purpose of this letter

We group firms in portfolios based on broadly similar business models. Your firm belongs primarily in the Retail Banking portfolio but also in the RMLs portfolio, which is characterised by firms that take deposits <u>and</u> offer regulated mortgage contracts. You should have already received a similar letter from my Retail Banking colleagues dated 5 February 2021 which relates to your organisation's retail banking activities.

Over the last 2 years our supervisory strategy for the RMLs portfolio has been dominated by coronavirus (Covid-19). This was a departure from our planned 2-year supervision strategy which started with a workshop on arrears management, held shortly before the pandemic.

This letter is forward looking, in respect of your firm's activities in the RML portfolio (regulated mortgages), and sets out:

- Our views on the key risks of harm for RMLs' mortgage customers over the next 2 years
- Our expectations about what RMLs 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 those for 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 yourselves.

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 RMLs 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
- RMLs support their customers through a period of payment difficulties and uncertainty, including by considering their other debts and essential living costs
- RMLs recognise the characteristics of vulnerability and respond to customers' particular needs
- RMLs 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. RMLs signpost or refer them to debt advice if appropriate

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

More generally, we expect RMLs 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 RMLs 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.

We expect RMLs 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 RMLs are required to conduct affordability assessments, this remains important to get right. RMLs 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 RMLs, 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 RMLs 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. 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, RMLs 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. RMLs 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.

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

We expect RMLs 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 RMLs 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: 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 RMLs to play their part in helping the economy adapt to a more sustainable long-term future. We've seen encouraging steps taken by some RMLs, 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 are now consulting on specific rules and guidance in a second consultation paper. Please let us know what you think the Consumer Duty means for you and how you might embed the proposals. The consultation is open until 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.

RMLs 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 RMLs.

As mentioned earlier, it is of great importance to the FCA that RMLs 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 RMLs, 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.

Our 2019/20 Business Plan highlighted the fair treatment of customers who take out second charge loans. This, and the second charge market more broadly, remains of interest and we will continue to use different sources of data to assess potential harm.

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.

In line with our shift to become more assertive in using our powers, 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, and you are a fixed portfolio firm, please contact your Supervisor in the first instance. If you are not, 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