MORTGAGE PRISONERS

An introduction to the problem

A 'Mortgage Prisoner' is a residential mortgage customer who is paying a high rate of interest on their mortgage when compared with other rates in the market and who cannot escape by refinancing.

This page tells the story of Mortgage Prisoners: how they were produced by the financial crisis in 2007 and 2008; how they have been mistreated and forced to pay high rates of interest; how Mortgage Prisoners have begun to fight back; and, as an afterword, what Harcus Parker can do to help.

<u>Mortgages with Northern Rock, Bradford & Bingley and Mortgage Express</u>

Northern Rock and Bradford & Bingley (including its subsidiary, Mortgage Express) were nationalised in 2008. Once in Government ownership, Northern Rock (rebranded as 'NRAM') and Bradford & Bingley stopped actively competing for new customers or offering new mortgage products to their existing customers. In effect, they became 'inactive' or 'zombie' banks and sought to run down their residual mortgage portfolios either by accelerating redemptions or by encouraging disposals. Individuals, families, and people with successful careers or successful businesses who had taken out mortgages with Northern Rock, Bradford & Bingley and Mortgage Express suddenly found themselves with lenders which had fundamentally changed.

The mortgage market tends to operate as a cycle: fixed-term deals are replaced at the end of their term with new fixed-term deals, without borrowers ever being charged the reversionary rate or 'SVR'. Before they were nationalised, Northern Rock, Bradford & Bingley and Mortgage Express operated on this basis. People who took out mortgages with one of these lenders expected to be able to re-mortgage onto new fixed-term deals after the end of the initial period. After they were nationalised, borrowers found that, contrary to their expectation, they were trapped paying unusually high SVRs.

Some customers of the newly nationalised banks were able to re-mortgage with other lenders, but many could not. There were various reasons for this. Sometimes the value of the borrower's house decreased so they had insufficient equity in their home to satisfy a new lender; sometimes the problem was caused by the introduction of new affordability rules in response to the financial crisis. When a lender gives a mortgage to a new customer, they must carry out an assessment and demonstrate that the mortgage is affordable. Under these rules, Mortgage Prisoners find themselves in the ironic situation of being told that they cannot afford a cheaper mortgage with a new lender despite the fact they are up-to-date with their payments on their existing mortgage. The Government and the financial regulator, the Financial Conduct Authority (the '**FCA**'), have accepted this is a problem and the FCA has recently proposed changes to the affordability rules to make it easier for mortgage customers to switch lenders. Unfortunately, this will not address the fact that customers have been unable to switch for years and suffered significant harm as a result.

The Government's decision to put the legacy mortgage books of Northern Rock, Bradford & Bingley and Mortgage Express into inactive lenders cut off customers whose mortgages were affected from an essential feature of the mortgage market if they could not switch to a different lender: the ability to re-mortgage. It can be much easier to re-mortgage with your existing lender than trying to switch to a different lender. Your current lender is not required to jump through the hoop of carrying out an affordability assessment if you want to re-mortgage with them and you are not looking to increase the amount you are borrowing. Lenders may make mortgage products available to their existing customers which are not available to new customers. By cutting off many borrowers from the ability to re-mortgage, the Government gave borrowers no choice but to pay their lender's reversionary rate or SVR once their fixed-rate mortgage deals ended. The borrowers are effectively imprisoned by their mortgages. This has often had life changing repercussions.

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Mortgages with Other Lenders

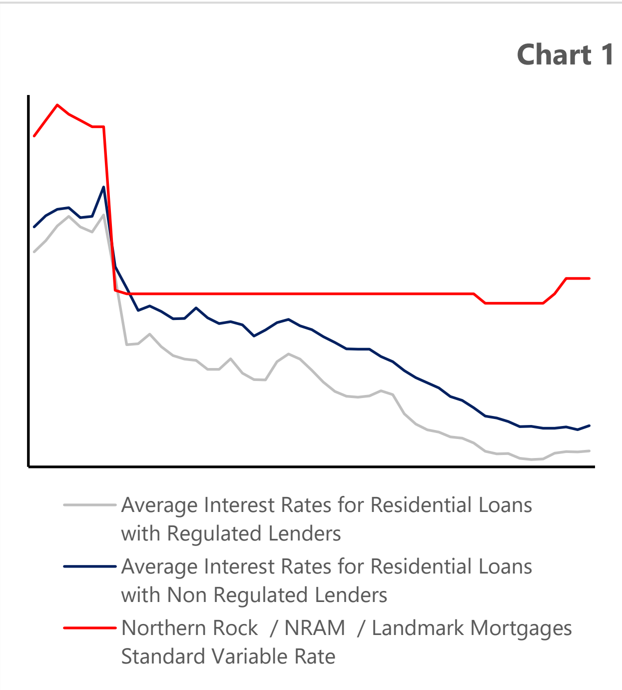
While many Mortgage Prisoners took out mortgages with Northern Rock, Bradford & Bingley and Mortgage Express, some took out mortgages with other lenders which were not nationalised such as GMAC RFC. GMAC RFC may not be a household name today but at one stage it was one of the top 10 biggest mortgage lenders in the United Kingdom. It floundered during the financial crisis in 2007 and 2008, and it filed for bankruptcy in May 2012. Its United Kingdom mortgage book was sold. Many mortgages were sold to a subsidiary of The Co-operative Bank called Mortgage Agency Services ('**MAS**'), which unlike The Co-operative Bank itself is an inactive lender and does not offer new mortgage products. The consequences for borrowers whose mortgages are now with MAS are the same are those whose mortgages were with the nationalised lenders.

The Disposal of Mortgages by Northern Rock, Bradford & Bingley and Mortgage Express

Over the last ten years mortgages that were with Northern Rock, Bradford & Bingley and Mortgage Express have been sold or transferred by the Government to other lenders. The old Northern Rock company was sold in its entirely to a private equity firm called Cerberus Capital Management in 2016 and renamed Landmark Mortgages. Other Northern Rock mortgages have ended up in a subsidiary of the TSB Bank called Whistletree.

A common factor in these disposals is that the new lender is also inactive in the mortgage market, or if they are active, as in the case of TSB Bank, they are careful to hold and manage the mortgages in an inactive subsidiary. Borrowers are still constrained by the same barriers to switching that they faced before their mortgages were sold or transferred. They continue to be trapped by their mortgages. The only exception was the sale of a portion of the Northern Rock mortgage book to Virgin Money in 2009/10. These mortgages ended up with a lender which actively participated in the mortgage market and was able to offer new mortgage deals.

The Exploitation of Mortgage Prisoners: How Borrowers are Forced by Lenders to Pay High Interest Rates

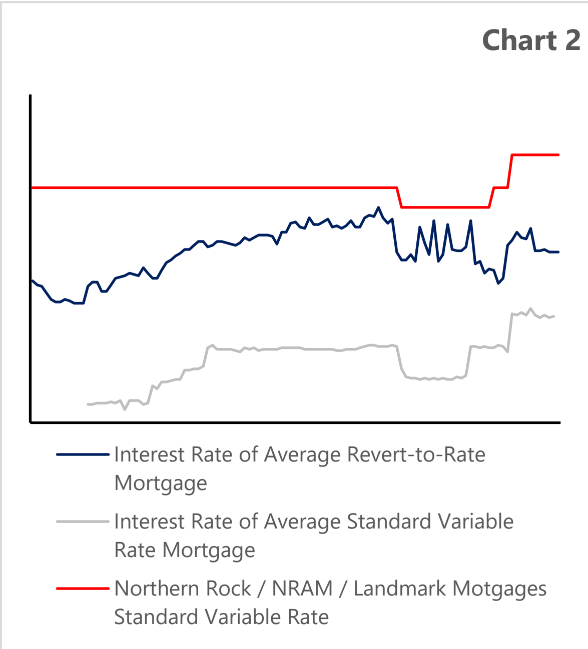


The interest rates Mortgage Prisoners are paying are much higher than interest rates available at other lenders.

First, borrowers do not have access to new fixed-rate deals. They have to pay their lender's reversionary rate or SVR, which tends to be much higher than the typical fixed-rate deal available in the market. The gulf between the two is shown in Chart 1, which compares the SVR of the old Northern Rock company with the average interest rates for residential loans with regulated and non-regulated lenders between early 2007 and early 2019.

Secondly, borrowers are forced to pay a high reversionary rate or SVR. Mortgage contracts are normally worded in a way which gives lenders licence to set their reversionary rate or

SVR at whatever level they decide to set it at. When a lender is active in the mortgage market they are trying to attract new customers and retain existing ones; there is a competitive pressure on them to keep their reversionary rates or SVRs at a low level. This vanishes if a lender is inactive. The only pressure on the level of the reversionary rate or SVR is an upwards one to set the rate at as high a level as possible. There is an added incentive for the nationalised lenders to increase their interest rates to a high level because their ultimate objective is to dispose of and run down the mortgage books. By squeezing borrowers with a high rate, the nationalised lenders are looking to encourage mortgage redemptions, and the profitability of their mortgage books are boosted, making them more attractive to buyers.



The high reversionary rate or SVR which Mortgage Prisoners are charged is illustrated by Chart 2, which compares the SVR of the old Northern Rock company under the names it successively assumed (NRAM and then Landmark Mortgages) with average revert-to rates and SVRs in the United Kingdom's residential mortgage market between early 2010 and early 2019.

What is hiding in these numbers is the impact high interest rates have on the lives of Mortgage Prisoners. We have spoken to people whose families have been broken apart, who have lost their businesses, and say they have suffered interminable and sometimes life-threatening health problems because of the high cost of their mortgages and the strain they are put under as a result.

The Campaign to Help Mortgage Prisoners

The problem of Mortgage Prisoners has been known about for several years, but it was not until the BBC broadcast a Panorama programme called 'Trapped by my Mortgage' about the issue on 22 October 2018 that it started to become common knowledge among mortgage customers who may have been affected.

The Panorama programme is available on the BBC iPlayer. Since the Panorama programme, Mortgage Prisoners have teamed up to organise a letter writing campaign to the Government, MPs, and the FCA. They have also organised meetings with MPs in Parliament and with the FCA.

The start of the campaign preceded a series of breakthroughs for Mortgage Prisoners.

First, on 3 March 2019 the FCA published the Final Report of its Mortgages Market Study. One of the report's stated objectives was to understand '*the extent to which mortgage prisoners were suffering harm, and what can be done to help them.*' It found that '*consumers are incurring harm if, now or in the future, they are unable to switch to a more affordable mortgage despite being up-to-date with their mortgage payments. This is because the consumer is paying higher than necessary mortgage* *payments.*' And that '*the harm for each, from paying relatively high reversion rates over an extended period, is significant.*'[1].

Secondly, the FCA opened a consultation on changes to the affordable lending rules on 26 March 2019 with the aim of making it easier for Mortgage Prisoners to take out a new mortgage with a different lender. You can read about the proposed changes in the FCA's consultation paper[2]. The consultation closed on 26 June 2019 and the FCA is scheduled to report its findings towards the end of 2019.

Thirdly, many MPs are supporting Mortgage Prisoners who have contacted them about the issues they are facing, and are pursuing the issue in Parliament and directly with the Government. In May 2019 a cross-party group of MPs set up the All Party Parliamentary Group ('**APPG**') on Mortgage Prisoners with the stated purpose of ensuring:

> *that all mortgage prisoners are given a fair deal and fair treatment (including by any organisation to which their mortgage is or might be assigned) and explore the issues relating to the ability of customers to switch mortgages including affordability criteria and associated regulatory changes.*

The website of the APPG on Mortgage Prisoners can be found here: https://www.appgmortgageprisoners.com/.

We have also heard of at least one MP who, in response to the large number of her constituents who are affected, has organised special meeting for Mortgage Prisoners in her constituency to discuss the issues.

Fourthly, the APPG on Fair Business Banking sponsored a debate in the House of Commons on the problem of Mortgage Prisoners, which took place on 6 June 2019. The MPs who spoke in the debate were all sympathetic to the problem and wanted to find a solution. They recognised the intrinsic unfairness of being trapped in an expensive mortgage.

Opening the debate, Charlie Elphicke said:

> *Who are the mortgage prisoners? They are people who are trapped by changes in mortgage regulation. They are trapped in expensive mortgages, unable to remortgage to get a better deal. The rules say that they cannot afford payments on a mortgage of, say 2% so they are forced to continue with a mortgage of 5% or more. It makes no sense at all. It is estimated that there are up to 200,000 mortgage prisoners in the United Kingdom today. Every one of those 200,000 families has a story to tell about how they stuggle to get by, forced to keep up payments to keep a roof over their heads, often going without.*

John Glen, the Economic Secretary to the Treasury, responded for the Government:

> *I recognise that this a hugely stressful and difficult situation for the individuals concerned, and it is clear to me that they face an unfair regulatory barrier [to re-mortgaging with a new lender]. Therefore, it has been my priority as Economic Secretary to find a solution That is why I instructed—not reluctantly or grudgingly, but determinedly and assuredly—Treasury officials*

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[1] The report can be read in full here: https://www.fca.org.uk/publication/market-studies/ms16-2-3-final-report.pdf

[2] Available here: https://www.fca.org.uk/publication/consultation/cp19-14.pdf

to work with the FCA, which is ultimately responsible for regulations, to consider ways of helping trapped borrowers switch more easily in future.[3]

Both the Government and the FCA recognise the problem of Mortgage Prisoners and the harm done by the high interest rates they are paying. However, the proposed changes to the affordable lending rules will not provide Mortgage Prisoners with recompense for the high interest rates they have been paying for years, and they will not allow all Mortgage Prisoners to switch. The changes are a start to resolving the problem, but they do not go far enough.

How the Claims we are Bringing will Help Mortgage Prisoners

The case we are intending to bring on behalf of Mortgage Prisoners is that they have been paying an excessively high rate of interest on their mortgage and should have been paying a lower rate. If we are successful, borrowers would be entitled damages, which we contend should be the difference between what the borrowers have actually paid on the higher rate over the last six or more years and what they should have paid under the lower rate. For some, this would amount to tens of thousands in damages. A successful outcome may also make lenders improve the way they treat Mortgage Prisoners going forward.

We cannot guarantee that we will be successful, and we are expecting a tough battle with the lenders, but if we are, this is the outcome we are hoping to achieve for Mortgage Prisoners. We hope this will provide them with some redress for the wrongs we believe they have suffered.

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[3] The debate is recorded in Hansard and can be found here: https://hansard.parliament.uk/Commons/2019-06-06/debates/029457C4-5BC6-49F3-91BC-3A8127A373E6/MortgagePrisoners. Alternatively, you can watch the full debate here: https://parliamentlive.tv/event/index/5ef93c1a-758d-4359-9e64-69f96844ec9d