Releasing the mortgage prisoners

Annexes to the final report

November 2020

A Methodology and data 1
B Standard variable rates as of June 2020 and historic relation with Bank of England rate 5
C Policies to help mortgage borrowers in Ireland 11

LSE London

Annex A: Methodology

Mixed-methods project (Jan – June 2020) involving

- Literature review
- Information collection:
  - Identification and assembly of data about mortgage prisoners and their loans
  - Interviews with key stakeholders
- Statistical modelling and analysis of findings
- Identification of possible solutions

1 Literature review

Key publications about mortgage prisoners and possible solutions including

Government and policy papers
Industry publications
Academic articles

Academic literature on the links between physical and mental health and mortgage debt problems, policies for dealing with mortgage-debt problems, and debt problems generally

Main sources include
(in the UK)

UKAR
Financial Conduct Authority
National Audit Office
S&P Global Ratings
MSE
UK Finance (formerly Council of Mortgage Lenders)
MHCLG
Resolution Foundation
House of Commons Treasury Select Committee

(abroad)

IMF
Banking & Payments Federation Ireland

2a Data assembly

We set out to compile information on prisoner loans and borrowers, and on similar borrowers who are not prisoners, in order to segment the prisoner population, understand the financial situation of each group, and recommend appropriate set of policies

We sought granular data on

- Prisoners themselves (employment status, income, age, other debts, etc.)
- Loans (distribution in terms of amount, LTV, repayment type, remaining term, etc.) of both prisoners and similar borrowers

There is no single source of disaggregated data on mortgage prisoners or their loans. The research team therefore compiled its own dataset, which is partial. Much of the data appears in documents prepared for investors, and finding and compiling the information was a major and time-consuming element of the research process. We mainly looked at loans that were previously in UKAR ownership, although there are other closed-book portfolios containing prisoner loans.

Key sources of information on loans and policy (see references for details)

- Financial Conduct Authority:
  - Understanding Mortgage Prisoners (2020) summarises information on c250,000 loans
  - Mortgage Market Study (MS 16/2.2 & MS 16/2.3)
  - Work on responsible lending (CP 19/14 & PS 19/27)
- UKAR
- Records of loan book sales 2011 to 2019, and correspondence
- HM Parliament
- Treasury Select Committee
- Publications from the APPG on Mortgage Prisoners
- National Audit Office Report into Cerberus purchase
- Standard & Poor's: *More than one-third of UK Legacy borrowers are mortgage prisoners* (2019)
- RMBS issues identified as related to UKAR loan sales

RMBS: Prospectuses

We acquired prospectuses for 5 of the 7 identified RMBS deals involving UKAR sales of home-owner loans (as opposed to buy-to-let). There may be others not yet identified and/or not in public domain. They provide snapshots at issuance date for

Size of mortgage
LTV
Arrears
Remaining term
Repayment type (interest only or repayment)
Type of interest rate (SVR, fixed etc)
Mortgage rate
Year of origination

RMBS: other information

Investors in many RMBS deals get monthly or quarterly data reports that describe how loans are performing. These reports are not public. We identified investor reports for a few RMBS transactions, and loan-level reporting for the life of one RMBS deal. Ratings agencies produce reports on specific RMBS deals, which give details of the changing shape and profile of RMBS portfolios; we acquired reports covering 4 deals.

Key sources of information on prisoners

There is limited information available on characteristics of prisoners themselves, as opposed to their loans. The FCA's *Understanding Mortgage Prisoners* has some information, which was supplemented by its July statement on mortgage prisoners, and there is some partial/qualitative data assembled by consumer-facing groups including UK Mortgage Prisoners, StepChange and MoneySavingExpert itself.

Benchmarking: other relevant data sources

- Loan-level information on c30,000 closed book securitised loans that are not UKAR-related
- UK Finance whole of market summary data
- NMG Bank of England loan level information on c18,000 residential mortgage loans
- StepChange information on mortgage borrowers in difficulty from 2005-2014
- CACI knowledge base on the economic, demographic, social and financial behaviour by geo-demographic grouping for UK households
- Experian FSS geo-demographic profiling description

- Case studies of the credit history of borrowers (inc ex Northern Rock customers) who have suffered possession

Because of the dearth of direct data, we have based our analysis of likely prisoner characteristics on information about groups that are similar demographically and in terms of debt profiles.

2b Interviews

15 interviews conducted with

Consumer advocates
Mortgage prisoner representatives
Regulators
Lenders
Government
Industry analysts

All interviews were on a Chatham House basis to enable frank discussion

3 Statistical modelling

Understanding debt difficulty is complex. Harm depends on the interaction of economic, financial, demographic and social factors, and no two households are the same. To understand these interactions we used two main techniques:

- Econometric techniques to estimate the probability of harm given a household's specific characteristics. We used data from household surveys, together with information provided to potential investors about the credit quality of closed loan books. These techniques are akin to those used by credit reference agencies to assess the creditworthiness of potential borrowers.
- Geo-demographic profiling techniques which use survey information on the characteristics of the U.K. population summarised into specific groups defined by postcode information. These techniques are complementary to credit scoring techniques and are commonly provided by the companies that provide credit scores.

Annex B: Standard Variable Rates as of June 2020, and historic relation with Bank of England rate

Table B1 provides Standard Variable Rates by type of lender as of mid-June 2020. Summary figures appear at the bottom of the table. They indicate that SVRs charged by closed-book lenders are broadly in line with those charged by many active lenders. Only the major banks, plus Nationwide and TSB, charge significantly lower SVRs than the closed-book lenders. The median closed book rate is below the median rate for the whole market.

Table B1: Current SVRs by type of lender, June 2020

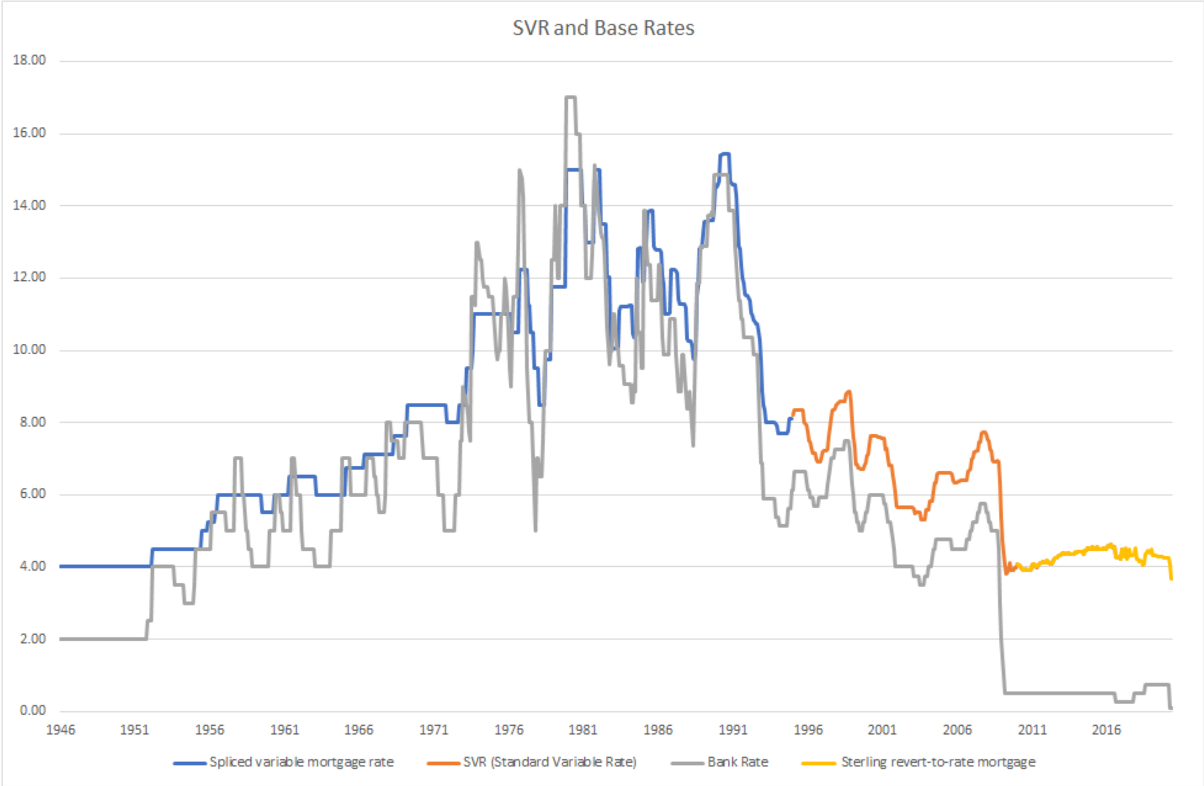
Major banks	**SVR**
Barclays (RFB)	3.59
Halifax	3.59
Lloyds Banking Group (RFB)	3.59
Natwest (RFB)	3.59
RBS	3.59
Santander (RFB)	3.35
Average	**3.55**
Median	**3.59**
Other lenders	
Atom Bank	3.5
Bank of Ireland	4.2
Co-operative	4.34
Virgin Money	4.34
Platform	4.34
Kent Reliance	4.5
Metro Bank	3.6
TSB	3.59
Aldermore	4.58
Precise Mortgages	5
Kensington	4.25
Average	**4.20**
Median	**4.34**
Building societies	
Nationwide	3.59
Coventry	4.49
Yorkshire	4.49
Skipton	4.64
Leeds	5.29
Principality	5.05
West Bromwich	3.99
Newcastle	5.99
Cumberland	4.09
The Family	4.39
Progressive	4.35
Cambridge	4.89

Newbury	3.95
Monmouthshire	4.74
Leek United	5.19
Saffron	5.39
Furness	5.04
Hinckley & Rugby	5.89
Ipswich	5.24
Darlington	5.3
Marsden	5.7
Melton Mowbray	4.99
Hanley Economic	4.79
Scottish	4.94
Mansfield, The	5.75
Tipton & Coseley	4.94
Bath Investment	4.9
Swansea	4.6
Harpenden	4.19
Vernon	5.2
Loughborough	5.34
Teachers	5.24
Stafford Railway, The	2.95
Buckinghamshire	4.74
Chorley & District, The	5.24
Beverley	4.99
Ecology, The	4.15
Earl Shilton	4.89
Penrith	4.75
Average	**4.83**
Median	**4.9**
Closed-book lenders	
Landmark	4.39
Heliodor	4.39
Whistletree	4.39
Tulip/Grasmere	4.39
MAS 5	5.35
UCB	5.09
Average	**4.67**
Median	**4.39**
Summary: SVRs by type of lender	**Average**
Major banks	3.55
Other lenders	4.29
Building societies	4.83
Closed book lenders	4.67
Overall	***4.59***

Source: lender websites, accessed 18 June 2020
Averages are unweighted

Figure B1 charts the long-term relationship between SVRs and base rates, using the Bank of England's historical database, updated by their recent statistical releases for the two variables. The data are monthly from the end of the second world war.

Figure B1: Mortgage SVRs (or equivalents) and base rates, 1946 - 2020

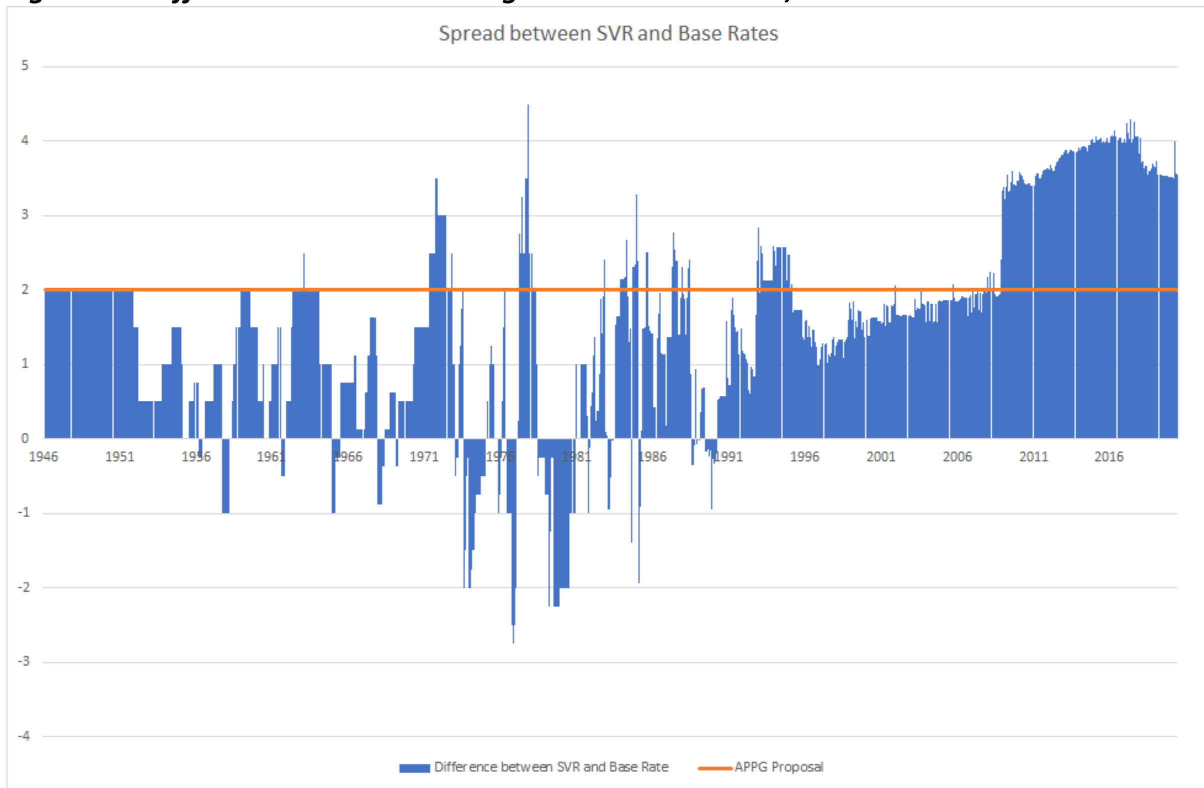


Source: Authors' calculations based Bank of England data

The same data are expressed in Figure B2, which shows the difference between SVRs and the Bank of England's base rate. The charts show that that SVRs and bank rate do not move together, but that there is a fairly close correspondence throughout most of this period. The gap widened sharply after the Global Financial Crisis to about 4%, where it has remained since.

The historical average difference between average SVR and bank rate is 1.52% and the median 1.63%; these include the post-GFC period, so the pre-crises figures would be much smaller.

Figure B2: Differences between average SVR and bank rate, 1946 - 2019



Source: Authors' calculations based on Bank of England data

Annex C: Policies to help mortgage borrowers in Ireland

Ireland like the UK faced a severe downturn post-GFC, which resulted in a huge rise in mortgage arrears, bank failures, the creation of a 'bad bank', and the sale of mortgage books to unregulated loan owners (ULOs) or 'vulture funds', as they have been dubbed by the media. This annex sets out how Ireland has handled the problems associated with closed mortgage books. As in the UK, the situation in Ireland continues to evolve. The text was last updated in August 2020.

Ireland has a continuing problem of mortgage arrears: according to the CBI's latest Statistical Release (CBI 2020), some 42% of all mortgage loans in arrears are overdue by 720 days (two years) or more. The Irish Central Bank's 2020 consumer and investor-protection priorities include the protection of borrowers in mortgage arrears, and the CBI said it would require 'all loan owners to put in place long-term sustainable arrangements where possible for their borrowers'. (RTE 2020)

'Vulture funds' and regulation

In the years since the GFC a number of investment funds, mostly based outside Ireland, acquired mortgages from banks, building societies and the Irish Bank Resolution Corporation (IBRC), whose function was analogous to UKAR. As of June 2019 nearly 34,000 mortgages were owned by these 'vulture funds' amounting to over €6 billion of debt. Nearly €4 billion of this amount was in arrears.

The activities of these funds have been controversial, and many activists say their pursuit of profit has led to serious detriment for consumers. One debt campaigner said, 'They are not concerned with how they are perceived. This enables them…to pursue aggressive strategies with scant regard for mortgage holders or the long term consequences' (Byrne 2019 p. 10). Others say their requireinment to turn a profit within the five-year timeframe of a securitisation may mean these funds are more motivated to sort out problems quickly.

The Irish government has moved in the last few years to increase regulation of these funds. Under the Consumer Protection (Regulation of Credit Servicing Firms) Act 2018, introduced as a private member's bill, unregulated loan owners must appoint a regulated lender or credit servicing firm authorised by the Central Bank of Ireland (CBI) to service the loans. ULOs could apply to the Central Bank for authorisation to carry out these functions themselves; those who did so became credit servicing firms (CSFs). So far, 38 firms have been authorised as non-bank CSFs (although not all are mortgage related); in addition a number have transitional registration. Loan-book owners including Promontoria (Cerberus), Tanager, Beltany, Mars, Link and Lapithus are all either authorised or have transitional registration. The CBI said, 'The law ensures that whoever is ultimately calling the shots on the management of a loan portfolio will be regulated' (O'Dwyer 2018).

According to Irish Central Bank statistics, in 2018 CSFs owned about 12,400 principal-residence mortgages in Ireland, or about 1.6% of the total. By March 2020 this figure had fallen to 9,600 (1.3%). The numbers are thus relatively small compared to the total number of loans outstanding and their books have been shrinking. The proportion of loans in arrears had risen sharply between 2018 and 2020—from 47% to 62%--for the loans owned by CSFs; by contrast, only 3% of the loans owned by banks were in similar arrears. CSFs account for a disproportionate number of possession cases, according to recent research by the Centre for Housing Law, Rights and Policy (2020). Although the number of loans

held by these funds is falling, loan sales continue, and the Banking and Payments Federation has produced guidance for borrowers whose loans have been sold (BPFI 2019).

Partly due to pressure from the CBI, the government and the media, the CSFs have become more engaged in enabling borrowers to restructure. This seems to improve borrowers' ability to repay their loans: of the loans owned by CSFs that had been restructured (18% of their portfolios as of March 2020), the 90+-day arrears rate fell to 6%.

According to informed observers, Cerberus has been particularly active in pursuing restructuring, offering some borrowers a payment of £20,000 a write off outstanding arrears as an incentive for selling their homes. Some observers said closed-book owners could be motivated to deal with borrowers quickly as they typically have a 5 year window – the life of a securitisation- to achieve resolution, remediate poorly performing loans and undertake resales.

Policies to help borrowers

Policy in Ireland has focused on helping customers and lenders find a way to sustain loans and on keeping people in their homes (even as tenants). As in the UK there have been major concerns about the treatment of borrowers in such circumstances.

The package of measures in place in Ireland has slowly built up over time. The country experienced a wave of mortgage defaults in the wake of the GFC, and the government in 2009 introduced a time-limited ban on repossessions. In 2009 the authorities introduced a Code of Conduct on Mortgage Arrears (CCMA) and a Mortgage Arrears Resolution Process (MARP). Under the CCMA, lenders (and credit servicing firms in the case of loans held by unregulated loan owners) must exhaust the options available from the suite of alternative repayment arrangements before taking action which may result in the borrower losing their home (whether by voluntary sale or repossession).

There have been two key schemes:

(a) Mortgage to Rent

In 2012 the Irish government set up a mortgage to rent scheme through which properties are sold to housing associations or private companies, then leased back to the State through the local authority. There are four key providers: two housing associations, a private provider and a charity. After the sale the homeowner's residual debts are written off and the family then becomes a tenant of a local authority, paying an affordable income-based rent.

In the early days, closed-book funds were less active than other types of lender in this scheme, and CBI research reportedly found that 'a borrower is less likely to get a long-term restructure on their loan from a vulture fund than from a bank' (RTE 2019). Last year however it was reported that their views had changed:

> "Funds were not doing mortgage-to-rent, as it was seen as taking a long time and was deemed to be expensive. "But funds now see it as a strategy to get rid of distressed loans. Funds realise the courts don't work, so they are prepared to look at other solutions." Mr Cunningham said the scheme had "now taken off massively", and there was what he described as huge buy-in from mainstream banks and funds that have bought portfolios of distressed loans.

As of 1Q2020, a total of 5,317 cases had been submitted under the Mortgage to Rent Scheme, of which only 660 had been completed. There have been criticisms about the poor take-up, blamed partly on the heavy bureaucratic burdens of the scheme. Despite a slow start, one major provider (Home for Life, which is funded by the AIB), expects up to 10,000 families to avail of mortgage-to-rent schemes in the next few years.

(b) Loan restructuring

A variety of loan restructuring options are in use in Ireland including forbearance, arrears capitalisation, interest only. As of end-March 2018, 117,334 principal dwelling house mortgage accounts had been restructured since 2009. About two-thirds of restructurings involve capitalisation of arrears, splitting the mortgage or term extensions (Table C1). The split mortgage allows borrowers to 'park' an agreed portion of their mortgage at 0% interest. This results in a temporary reduction of overall monthly payments thus leaving a balloon payment which needs to be made at some time.

Table C1: Restructured principal-dwelling mortgage accounts by restructure type, end-March 2020

Restructure type	Share
Arrears capitalisation	31.41%
Split mortgage	26.02%
Other	19.73%
Term extension	11.46%
Reduced payment (greater than interest only)	4.11%
Temporary interest rate reduction	3.55%
Interest only - over one year	1.14%
Payment moratorium	0.65%
Reduced payment (less than interest only)	0.49%
Permanent interest rate reduction	0.14%
Trade down mortgages	0.07%
Deferred interest scheme	0.00%

Source: Central Bank of Ireland 2020

A breakdown of restructuring techniques used by different types of lenders (CBI 2018) showed that closed funds/CSFs tended to use reduced payments, while banks and non-banks were most likely to use arrears capitalisation.

Conclusions

Ireland has a more developed system for dealing with closed funds and mortgage restructuring than does the UK. It has taken time to achieve - over a decade -- and many in Ireland would argue that the situation is still unsatisfactory. However the mortgage to rent scheme, loan restructuring and the regulation of closed funds all point to a tougher regime. In addition, unlike in the UK, the mainstream banks have been active in acquiring mortgage funds. Overall Ireland can clearly offer lessons for the UK.

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