

Bank of England PRA

Appendices to CP6/26 – High loan to income lending

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Draft for consultation



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1. Introduction

1.1 This Supervisory Statement (SS) is relevant to all firms in scope of the Housing Part of the Prudential Regulation Authority (PRA) rulebook. PRA rules also require the relevant firms to apply the rules at UK subsidiary level in relation to firms not already within the rules' scope.

1.2 This statement sets out the PRA's expectations for firms entering into high loan to income (LTI) mortgages¹. Specifically, it sets standards for the management of a firm's 'high LTI flow', defined in this SS as the percentage of all 'regulated mortgage contracts'² entered into in a calendar quarter that are high 'LTI mortgage contracts'. This SS should be read in conjunction with the requirements in the Housing Part of the PRA Rulebook.

1.3 Paragraphs 2.4 and 3.1-3.7 in this SS do not apply to firms below the 'de minimis' threshold. For the purposes of this SS, the 'de minimis' threshold is defined as firms that, during both of two consecutive sets of four quarters:³

- a) have entered into regulated mortgage contracts under which the total credit provided is less than £150 million; or
- b) have entered into fewer than 300 regulated mortgage contracts in each of those sets of four quarters.

¹ High LTI mortgage contract is defined in the PRA rules as a regulated mortgage contract under which the credit provided by a firm to an individual, or to individuals jointly, is or exceeds a multiple of 4.5 times the individual's income, or the individuals' joint income, at the time at which that income is assessed by the firm for the purpose of entering into the regulated mortgage contract.

² As defined in the Housing Part of the PRA Rulebook. The definition excludes buy-to-let mortgages, second charge mortgages, further advances, lifetime mortgages, retirement interest only mortgages, and re-mortgages with no change to the principle sum outstanding

³ Two consecutive sets of four quarters means (1) a first set of four quarters ending on the last day of the immediately preceding quarter; and (2) a second set of four quarters ending on the last day of each subsequent quarter.

2. Risk management expectations regarding high LTI lending

2.1 The PRA requires that a firm entering into high LTI mortgage contracts must conduct such business prudently.⁴

2.2 A firm engaging in high LTI lending should have in place a framework of risk management and compensating lending controls to ensure such activity is delivered in a prudent manner. This aligns with the requirements set out in the Risk Control Part of the PRA Rulebook. Where a firm is a member of a group, the risk management framework may be implemented for each relevant firm in the group or at a wider group level as appropriate. Where a group chooses to apply these expectations at group-level, the references to ‘firms’ in this Chapter should be read as applying to the group.

2.3 Where a firm makes risk management changes in order to increase its high LTI flow to a level above 15%, the PRA expects it to discuss these changes as part of regular engagement with Supervisors. The PRA will expect to see evidence of mechanisms in place to exercise effective oversight of the corresponding risk management and controls, supported with meaningful and well-targeted management information used to inform board discussions⁵.

The PRA expects that effective oversight should include:

- a) Risk appetite limits on high LTI lending;
- b) monitoring against any relevant risk limits, of:
 - i. the current flow of high LTI lending;
 - ii. the expected future flow;
 - iii. related credit concentrations and high-risk segments; and
 - iv. the performance of these mortgages.

2.4. In addition, a firm above the ‘de minimis’ threshold should also:

- c) monitor the aggregate flow of high LTI lending as published by the PRA;
and
- d) have assurance of its ability to make adjustments to reduce its future flow of high LTI lending if necessary.

⁴ Housing Part of the PRA Rulebook

⁵ This aligns with the expectations set out in SS5/16 – Corporate governance: Board responsibilities

3. Managing the aggregate consistently with the FPC's 15% limit

3.1. This Chapter applies to firms above the 'de minimis' threshold. Where more than one firm within a group is above the 'de minimis' threshold, references to 'firms' should be interpreted as applying to the group.

3.2 The PRA expects firms to monitor the aggregate high LTI flow level, as published by the PRA, against the FPC's 15% aggregate limit⁶ and consider how this may impact the firm's future flow of lending.

3.2 If, at any point, the PRA and FCA judge that the aggregate high LTI flow is at a level not consistent with the FPC's 15% limit, they may set expectations for any firm with an individual high LTI flow greater than 15% to take steps to reduce its future flow. The flow is measured on a fixed quarterly basis.⁷ The PRA expects that a firm's board should be responsible for overseeing these actions.

3.3 The PRA will publish a measure of the aggregate high LTI flow each quarter (described further in Chapter 4 of this SS). In the case that the aggregate flow is inconsistent with the 15% limit, and is expected to be inconsistent on a persistent basis over more than one quarter, the PRA will set out how it expects relevant firms to respond. When the PRA and FCA consider that the aggregate has returned to being consistent with the 15% limit, the PRA will set out that firms are no longer expected to make adjustments.

3.4 If the aggregate measure becomes inconsistent with the FPC's 15% limit on a persistent basis, the PRA will set out additional expectations on the PRA website for all firms lending above 15% to gradually reduce their flow of high LTI lending towards 15%. Firms should take necessary action to ensure that their individual future flow of high LTI mortgages is consistent with published PRA expectations. This adjustment should apply only to future lending decisions; firms are not expected to withdraw existing approved mortgage offers. Firms are expected to make any necessary adjustments in line with the timelines published by the PRA. Reductions in individual flow measures are not expected to be accurately reflected in data until three subsequent quarters have passed.

3.5 The rate at which firms are expected to reduce their flow of high LTI lending by will be expressed as a fraction, to be applied to the amount their individual flow measure exceeds

⁶ Chapter 4 sets out that the PRA will publish this figure to enable firms to monitor the aggregate.

⁷ Where relevant the PRA will measure LTI at group level, excluding any firms from the group that are below the "de minimis" threshold.

15% based on the latest available data.⁸ The PRA will state this fraction, on its website as part of its publication of the aggregate measure. The fractional reduction will apply, calculated iteratively for each successive quarter, until such time the PRA considers no further adjustment is necessary. The expected adjustment each quarter is based on the reduced excess above 15% expected in the previous quarter, so the size of each adjustment decreases over time. In determining the fractional rate of adjustment, the PRA will give consideration to the latest available data, supervisory intelligence and any known external market factors. For example, the PRA could communicate:

The PRA and FCA expect that any firm, or group where applicable, that has most recently measured high LTI flows in excess of 15% should take action to reduce its future flows, initially measured for [a given quarter], by [e.g. one fifth] of the amount its most recent measure exceeds 15% and again by [e.g. one fifth]⁹ in each consecutive quarter until its flow measure is equal to or less than 15%, or these expectations are amended or withdrawn, whichever occurs sooner.

3.6 The boxes below set out stylised examples of how firms lending above 15% may be expected to adjust following the aggregate becoming inconsistent with the 15% limit.

Example 1

In this example the aggregate measure has gradually become inconsistent with the FPC's limit and so the PRA sets expectations for relevant firms to reduce by the percentage point difference their individual flow measure exceeds 15% by one sixth in each successive quarter.

	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11
Individual high LTI flow (%)	16.0	17.0	17.5	17.5	17.5	17.1	16.8	16.5	16.3	16.1	16.5

A) The Q3 aggregate measure is published midway through Q4 and is judged to have become inconsistent with the FPC's limit. The PRA states that firms with a flow of greater than 15% should reduce the percentage point difference their individual flow measure exceeds 15% by one sixth in each successive quarter, with the first measure based on Q6 completions.

For the example firm, the most recent measure of its high LTI flow is 17.5%. The percentage point difference its individual flow measure exceeds 15% by is 2.5%. This

⁸ The PRA uses the Product Sales Data to calculate a firm's high LTI lending.

⁹ The size of excess for each firm is calculated at the point of aggregate overshoot. The fraction reduction for the first quarter is on the whole of that excess, and from the second quarter onwards is on a reducing balance, based on that original calculation.

difference, reduced by one sixth, is 2.1%. Therefore the firm should take steps to reduce its future flow to no more than 17.1% in Q6.

For the next quarter, the difference is reduced by one sixth again, to 1.8%. The firm should take steps to reduce its future flow to no more than 16.8% in Q7. The reduction should be applied successively in each quarter, such that the firm should reduce its future flow to no more than 16.5% in Q8, 16.3% in Q9, and so on until further notice.

B) The Q6 aggregate measure is published midway through Q7 and remains above 15%. The example firm is seen to have reduced its high LTI flow to within expectations.

C) The Q8 aggregate measure is published midway through Q9. The PRA confirms that the aggregate measure has fallen such that it is no longer considered inconsistent with the FPC's limit. The PRA states that it is withdrawing its expectations of firms to reduce their future flows. The example firm may take steps to increase its future flows, in line with its own risk appetite. In Q10, the high LTI flow continues to decrease for the firm as it is unable to influence this lending so soon after the expectations were withdrawn.

D) The Q11 aggregate measure shows that the firm has, following the withdrawal of expectations in Q9, increased its flow.

Example 2

In this example the aggregate measure has rapidly and sharply become inconsistent with the FPC's flow limit, so the PRA set expectations relevant firms to reduce the percentage point difference their individual flow measure exceeds 15% by one third in successive quarters.

	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9
Individual high LTI flow (%)	22.5	22.5	22.5	22.5	22.5	20.0	18.3	17.2	17.7

A) The Q3 aggregate measured is published midway through Q4 and is judged to have become inconsistent with the FPC's limit. The PRA states that firms with a flow greater than 15% should reduce the percentage point difference their individual flow measure exceeds 15% by one third in each successive quarter, with the first measured based on Q6 completions.

For the example firm, its most recent flow measure is 22.5%. The percentage point difference its individual flow measure exceeds 15% by is 7.5%. This difference, reduced by one third, is 5.0%. Therefore, the firm should take steps to reduce its future flow to no more than 20.0% in Q6.

For the next quarter, the difference is reduced by one third again, to 3.3%. The firm should take steps to reduce its future flow to no more than 18.3% in Q6. Applied successively, the firm should limit its future flow to 17.2% in Q8, 16.5% in Q9 and so on until further notice.

B) The Q6 aggregate measure is published midway through Q7. The PRA confirms that the aggregate measure has fallen such that it is no longer considered inconsistent with the FPC's limit. The PRA states that it is withdrawing its expectations of firms to reduce their future flows. The example firm may take steps to increase its future flows, in line with its own risk appetite.

C) The Q9 aggregate measure shows that the firm has, following the withdrawal of expectations in Q7, increased its flow.

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4. Calculation and publication of aggregate high LTI

4.1 The PRA will calculate and publish the aggregate high LTI flow figure on its website each quarter, available here [link to be inserted when final policy is published].

4.2 This aggregate figure will be calculated using the FCA's Product Sales Data (PSD). The PSD reporting periods are the four calendar quarters of each year beginning on 1 January. The aggregate figure will be calculated on a quarterly basis and updated on the webpage within a reasonable time following the submission of the data.

4.3 The calculation will consider regulated mortgage contracts as defined in the Housing Part of the PRA rulebook.¹⁰

4.4 Mortgages originated by firms below the 'de minimis threshold' are excluded from this calculation.

4.5 If the reported data is revised and there is a material change to the aggregate, the PRA will update the figure.

¹⁰ The high LTI aggregate calculation excludes buy-to-let mortgages, second charge mortgages, further advances, lifetime mortgages, retirement interest only mortgages, and re-mortgages with no change to the principle sum outstanding