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By email: cp19-14@fca.org.uk

Dear Laura,

CP19/14 Mortgage customers: proposed changes to responsible lending rules and guidance

This is the Financial Services Consumer Panel's response to the FCA's consultation on 'Mortgage customers: proposed changes to responsible lending rules and guidance'.

The Panel welcomes the FCA's attempt to tackle the issues facing mortgage prisoners as far as it is within its remit to do so. FCA analysis reveals there are 150,000-200,000 mortgage prisoners with a variety of different lenders. The reforms to the affordability test will help a significant proportion of these switch to a more affordable deal. However, given the severe and longstanding detriment found in this market, we urge the FCA to review its intention to wait 13 months before the proposals come into force and to consider fast-tracking the proposals.

The Panel's main comments on the FCA proposals set out in CP 19/14 are:

- the FCA proposals to remove barriers in its rules which stop mortgage prisoners switching to more affordable mortgages are very welcome. They should be introduced as soon as possible.
- additional flexibility around the affordability assessment should apply not just to customers up to date with their payments, but also to customers in arrears.
- the FCA should seek to ensure that mortgage prisoners who are unable to switch are treated fairly, even if their loan was sold on to a company not authorised for mortgage lending. A one-off requirement on lenders to write to potentially affected customers is insufficient. The Panel recommends that FCA should require all lenders to write to their customers within the first 3 months, and to send reminders at 6 months and 12 months.
- the FCA should consider commissioning a specialized broker to assist trapped borrowers to identify lenders willing to take them on.
- where the FCA does not consider it has appropriate powers to act to protect the interests of consumers it should, as a matter of urgency, raise this with HM Government and make the case for changes to its remit.

Our responses to the questions posed in the consultation paper are set out below.

Q1: Do you agree that our proposals should only apply to firms dealing with consumers that meet the conditions of 'eligible consumers'?

The FCA proposes that 'eligible consumers' must have a current mortgage, be up-to-date on mortgage payments, not want to borrow more (other than to finance product fees for the mortgage), and be looking to switch to a new mortgage on their current property.

The Consumer Panel considers that the FCA should broaden the criteria. Customers in arrears should also stand to benefit from the FCA's proposal to offer greater flexibility, unless they have reached the point where the lender would normally initiate repossession proceedings. Denying customers in arrears the ability to switch is deeply unfair - some consumers are only in arrears because they are currently being charged an excessive rate and could afford a cheaper deal, while others are technically in arrears because they have negotiated a repayment holiday, or reduced payments for a while (e.g. due to illness or job loss), and may not have been informed that doing so would lead to them being classified as being in arrears. In addition, the Panel understands that some mortgage lenders classify a customer as being in arrears if they cancel their direct debit, even if they continue to make their mortgage payment each month. This practice confirms the need to allow customers in arrears to benefit from the FCA proposals, and merits investigation by the FCA to determine whether it has led to unjustified and unnecessary damage to consumers' credit records. The Panel is concerned that excluding customers in arrears would allow lenders to single out customers in financial difficulty and leave them stranded on excessive standard variable rates with no prospect of switching to a better deal. It is not clear how this course of action would be in line with the FCA's operational objective to secure appropriate protection for consumers.

The FCA should also ensure that its proposals for a modified affordability test apply to:

- all existing customers remortgaging with the same firm, and those looking to do so within the same banking group. This will stop lenders from arbitrarily treating customers differently.
- 'mortgage prisoners' who have suffered from domestic violence or controlling behavior. These customers are already working to meet the entire mortgage payment on their own and should not be excluded from accessing the modified affordability assessment if they are removing their ex-partner from the mortgage.
- 'mortgage prisoners' who are consolidating their 'Together' loan (previously held with Northern Rock) into their mortgage. Many mortgage customers with Together mortgages will be able to demonstrate that they can meet the current level of payments on both the secured and unsecured elements of their loans and should not be restricted from benefitting from the new rules.

Q2: Do you agree that 'up-to-date with payments' should be decided by not being in payment shortfall, both at the time of application and over the previous 12 months?

As we state in our answer to Q1, we do not think that being up-to-date with payments should be one of the criteria which borrowers must meet to benefit from greater flexibility. However, if the FCA proceeds with its proposed approach to limit eligibility to people who are up-to-date with payments then it would seem sensible to look not just at a snapshot of the customer's payment performance at one point in time. Rather, the lender should look at their performance in making payments over the previous 12 months.

Should the FCA proceed on this basis then they should also set out clear expectations about what constitutes a payment shortfall. This should exclude customers who have negotiated a payment shortfall or reduced payments.

The Panel considers that arrears should not be a disqualification unless they have reached the point where the lender would normally initiate repossession proceedings. There are people formally deemed to be "in arrears" with the consent of the lender, particularly those who have an agreed reduction in repayments or a repayment holiday. In addition, there are people who are in arrears simply because their current repayment levels are unaffordable, but who would not have gone into arrears if they had been paying a more reasonable rate. To address these issues, we suggest that as a minimum the FCA makes clear that arrears per se should not necessarily prevent somebody from benefiting from the revised affordability assessment and transferring to a new lender.

Q3: Do you agree with our approach to defining a 'more affordable' mortgage, both where product or arrangement fees have been added to the mortgage and where they have not?

Defining a 'more affordable' mortgage is difficult due to the differences in how mortgage deals are structured and presented. The FCA's proposal to reflect such differences by separating out what constitutes a 'more affordable' mortgage, based on whether product and arrangement fees have been added to the mortgage or are payable upfront, is a reasonable approach.

The Panel recommends, however, that the definition of a 'more affordable' mortgage should be expanded to allow consumers to make increased payments where they switch from an interest-only to a repayment mortgage.

The Panel applauds the FCA for including detailed worked examples in Annex 1 to provide clarity on how 'more affordable' should be calculated. Such worked examples should also form part of any future FCA Policy Statement or confirmed Guidance.

Q4: What are your views on a definition of 'more affordable' that refers to both the interest rate during any incentivised deal period and the new lender's existing reversion rate at the time?

The Panel would support the definition of 'more affordable' referring to both the interest rate during the incentivised deal period and the new lender's reversion rate. In our view, this would give a clearer picture and help to ensure that customers stand to benefit from lower rates over a longer period, rather than being seduced by lower rates which apply only for a short time but which subsequently increase to a rate which is higher than that paid by the customer on their existing mortgage.

Q5: Do you agree that we should allow lenders to extend the term of the mortgage when they undertake the modified assessment?

The Panel agrees that the FCA should allow lenders to extend the term of the mortgage when they undertake the modified assessment, provided that it is made clear to the customer what the impact of this will be – namely that they will pay more in interest overall.

We also agree that where any extension to the mortgage term would take a customer beyond their anticipated retirement date, lenders should have to consider the customer's income how they would meet their obligations in retirement.

Q6: Do you agree with our proposal to only allow lenders to use the modified affordability assessment if they have a policy allowing consumers to switch to a more affordable mortgage?

Yes, we agree that only lenders which allow consumers to switch to a more affordable mortgage should be able to use the modified affordability assessment. This should protect consumers who switch to a cheaper deal but end up on a higher reversion rate which they are unable to afford, by ensuring they can switch to a more affordable mortgage product with their existing lender.

Q7: Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our income and expenditure rules (MCOB 11.6.5R to 11.6.15G)?

Yes.

Q8: Do you agree that we should require lenders to consider whether the consumer's income after retirement would be enough to enable them to meet their commitments under the contract?

Yes, we agree. It is important lenders consider whether the consumer's income after retirement would be enough for them to meet their commitments under the contract. However, we recommend that this provision should be disapplied if the consumer is already in retirement or if they are switching to a retirement interest-only mortgage. If the consumer is already retired or applying for a retirement interest-only mortgage then the sole test should be whether the mortgage is more affordable.

We also support the FCA's plans to issue guidance supporting this new rule to make clear that lenders should take a prudent and proportionate approach to assessing the consumer's income in retirement, and be able to evidence the basis on which any assessment was made.

Q9: Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our interest rate stress test rules (MCOB 11.6.18R to 11.6.19G)?

Yes.

Q10: Do you agree that we should introduce guidance that, if considering future interest rate rises, lenders may wish to take into account the fact that the consumer is currently meeting payments at a higher rate than on the more affordable mortgage?

Yes. The FCA's guidance should reflect the reality that the consumer has been making payments at a higher rate than they would have to do so on the more affordable mortgage.

Q11: Do you agree that we should allow lenders that choose to use the modified assessment to disapply MCOB 11.6.40G to 11.6.48R and MCOB 11.6.50R to

11.6.52G as long as the consumer is not trying to increase the proportion of the loan on an interest-only basis?

Yes, we agree. Consumers with interest-only mortgages who are not trying to increase the proportion of the loan on an interest-only basis should be able to benefit from more affordable mortgages, even if they do not have a credible repayment strategy in place. Failure to allow them to do so will simply exacerbate their problems.

The requirement for lenders to review interest-only mortgages and contact the customer to prompt a conversation and help them to find a repayment strategy if possible will remain, and will form an important safeguard to protect consumers.

Q12: Do you have views on whether the modified assessment should be available for home movers looking to switch to a new lender?

Yes, the Panel considers that the modified assessment should be available to home movers too. If this is not the case then the only option for consumers to obtain a more affordable mortgage would be to remain in their current property, even if this is no longer suitable for their circumstances.

Q13: Do you agree that we should require inactive lenders and administrators acting for unregulated entities to contact their customers and make them aware that our rules mean they may be able to switch to a new mortgage product with a new lender?

Yes, inactive lenders and administrators acting for unregulated entities must be required to contact their customers to make them aware that the FCA's new rules mean they might be able to switch to a new, and potentially cheaper, mortgage with a new lender.

Currently the FCA proposes that this communication is a one-off requirement that must be sent within 13 months of the introduction of the new rules. We urge the FCA to require swifter action and to fast-track the proposals. Many customers with inactive lenders and unregulated entities have paid more than they need to for some considerable time; offering them a potential route to a more affordable mortgage should be progressed as speedily as possible. The Panel recommends that all lenders should write to their customers within the first 3 months.

The Panel also disagrees with the FCA's proposal that the communication should be limited to a one-off requirement. While requiring firms to contact these customers on an ongoing basis may not be necessary, we would suggest that follow-up activity for non-respondents should be required. The Panel recommends that in addition to requiring that all lenders write to their customers within the first 3 months, the FCA should also require them to send reminders at 6 months and 12 months.

We also suggest that consideration is also given to the way these communications are delivered to maximise the likelihood of a response. The FCA should work with colleagues in its Behavioural Economics team who have conducted research into what works with consumers, as well as what captures their attention and prompts engagement and responses.

The Panel agrees that the FCA should undertake work to develop standard wording to be used in the communication and to set this out in its rules. We support a requirement to signpost customers to other sources of information, but suggest that this should specify certain trusted sources of information rather than leaving this to the discretion of firms in order to ensure consistency and the provision of accurate and up-to-date information.

The Panel welcomes the FCA confirmation that it wants customers to be informed about where they can go to find out more about what the changes rules mean for them. To make this a reality, the Panel recommends that the FCA, or possibly the Government, should consider commissioning a specialized broker to assist trapped borrowers to navigate through the maze of alternative provision. The role of the broker would be to identify lenders willing to take on the borrowers, which can be difficult for individual consumers to do on their own.

To ensure information is clearly signposted, details of the affordability test changes and a link to the relevant section of the FCA website which explains the changes should be included in the content of the annual mortgage statement required by MCOB 7.5.

In addition, the regulated administrators of loans for inactive or unregulated lenders should be required to display details of the changes on a dedicated section of their websites and should link to this information from the section on interest-rates using a hyperlink under the section "Would you like a new mortgage deal?"

Q14: Do you agree that administrators and inactive lenders should only contact customers that have a residential mortgage, that is not a lifetime mortgage, and who are up-to-date with payments and on a reversion rate?

The aim should be to ensure that all those who potentially stand to benefit from the revised affordability assessment are informed about the changed assessment and how they can take action. If such a segmentation can be achieved with complete accuracy then the Panel would support administrators and inactive lenders contacting only eligible customers. It is not in the interests of the firm to issue, or the customer to receive, communications about something for which they are not eligible.

If this is not feasible then it may be necessary to contact a wider group of customers to ensure that all those who may stand to benefit receive the relevant information. If this is the case, then it will be necessary for the FCA to facilitate a triaging approach to inform customers who are unlikely to get a new deal as early as possible in the process.

Q15: Do you agree we should require lenders to give this disclosure?

Yes, we agree that a consumer who switches under the proposed modified assessment should be made aware of the basis on which the assessment has been conducted and the potential risks associated.

Q16: Do you agree we should require lenders to report data on use of the modified affordability assessment?

Yes, lenders should be required to report data as it will be important that the FCA is able to understand how lenders have made use of the modified assessment, and whether further action is required.

Q17: Do you agree that we should amend SUP to state that, where lenders have sold a mortgage using the modified assessment, they are not required to report the affordability data required in PSD?

Yes, this appears sensible and would bring the SUP requirements into line with the rules associated with carrying out the modified assessment.

Yours sincerely,

Wanda Goldwag
Chair, Financial Services Consumer Panel