Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Lynda Blackwell
Mortgage Policy, Conduct Policy Division
The Financial Services Authority
25 The North Colonnade
London
E14 5HS

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Dear Lynda

Consumer Panel Response to CP11/31 * Mortgage Market Review (MMR)**

Please find enclosed with this letter the Consumer Panel's response to the above consultation. As you know we consider this to be an extremely important area of regulation for the FSA, given the impact it stands to have on millions of current and potential future mortgage holders. For that reason we have taken an intense interest in the MMR since its inception.

While at times in the process we have been critical of some of the FSA's previous proposals, and how they have been evidenced, I am pleased to say that we are much happier with the position the FSA has now reached. This is testimony to the huge amount of work the FSA has put into the MMR. The general tone of the proposals now appears to us to be far better balanced between the needs of different consumer groups and those of the industry, and for that reason the FSA should be applauded.

We do, however, still have some concerns and we set those out clearly in our response. Framing those concerns is our own six point plan for a sustainable and healthy mortgage market which we published last June.[1] The principles which we set out in that plan still hold and I would like to remind you of these and how we think the current proposals measure up against them:

1) *Effective regulation to help consumers* – While the FSA's proposals definitely go some way towards ensuring an end to irresponsible lending we are still not entirely convinced that they will not constrain the market for the millions of responsible borrowers. Therefore, in view of the inherent uncertainty of the FSA's impact estimates and the conclusions of two independent Peer Reviews commissioned by the Panel of the FSA's welfare analysis, we have not relied in our response on the FSA's central belief that its responsible lending requirements will prove "net beneficial in well-being terms".

[1] http://www.fs-cp.org.uk/publications/pdf/fscp_mmr_plan.pdf

2) *Regulatory policy to take account of wider social and economic implications* – The FSA's less prescriptive affordability requirements will undoubtedly lessen the potential impacts of the proposals on related markets such as those for rental and buy-to-let properties. Still, we remain keen to see greater evidence of joined up thinking and evidence of consideration of the potential changes to the home-ownership population brought about by the MMR.

3) *Lenders required to judge affordability and suitability for individual consumers* – This is perhaps the single biggest area where the FSA's revised proposals have indicated the regulator's willingness to listen to others and adopt a more balanced and proportionate approach. The removal of both the proposed buffer on standard affordability tests for the credit impaired and the proposal to restrict the maximum assessable mortgage term to 25 years are two such examples of this revised approach.

4) *Transitional arrangements which take account of the implications of the changes for all segments of the market* – We are already seeing firms in the market move to restrict loan-to-value and loan-to-income ratios, but this is problematic for those 'mortgage prisoners' unable to exit their current agreements if they find themselves paying significantly higher interest rates with no options to move elsewhere. We believe the FSA needs to strengthen its proposals in this regard and we put forward a more robust approach in our substantive response.

5) *A future regulatory structure responsive to consumers' needs* – The MMR does not dispel our concern that insufficient consideration has been given to the potential regulatory overlap between the FSA's proposals and the macro-prudential interventions that the Financial Policy Committee might take to avert an unsustainable lending boom. The FPC has recently called for more analysis and public debate, which we believe the FSA should lead.

6) *Balanced debate which overcomes the polarised views on the mortgage market* – We made the point in our 6 point plan that the "MMR debate has become unhelpfully polarised between those organisations that represent the interests of vulnerable consumers and industry representatives who focus on the overall market." The current proposals have been far less contentiously received by both sides, evidence of the far more proportionate approach taken by the regulator, which we support.

I hope you find the above points useful in setting out our overall response, which follows.

Yours sincerely,

Adam Phillips
Panel Chair

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CP 11/31 * – Mortgage Market Review**

Introduction

This is the Financial Services Consumer Panel's response to the FSA's consultation paper on the Mortgage Market Review (FSA CP11/31 ***).

The FSA's paper continues the process begun at the end of 2009 comprehensively to review the mortgage market regulatory regime introduced in October 2004. As we said in our responses to previous consultations, the Panel wholeheartedly supports the FSA's attempt to identify and address weaknesses in the mortgage market. In view of the problems in this market over the last few years, we are pleased that the FSA has attempted to establish clear expectations of improved behaviour by all market participants. In June last year we set out our own vision for a sustainable and healthy mortgage market and we draw on our plan of action in our response to this consultation.[1]

We start by offering our full support in a number of areas where we feel the FSA has responded admirably to concerns raised by ourselves and others.

When the FSA released its original Discussion Paper on the MMR (DP09/3) and followed it up later with its substantive policy consultation (CP10/16) much of what was proposed, certainly with regards to the assessment of affordability, was highly prescriptive and likely to have undesirable consequences for many creditworthy consumers. The revised proposals embody a clear shift in emphasis towards more straightforward and less prescriptive requirements in the most significant policy areas. We greatly welcome this shift.

We are particularly pleased that the affordability requirements have been modified, dropping the notion of a "free disposable income" test and the related proposals for a 25 year term requirement and the imposition of an extra buffer in the assessment of the credit impaired. Similarly sensible is the move to allow affordability to be calculated on an interest-only basis where there is a clearly understood and believable alternative source of capital repayment.

In our response to CP10/16 we were also critical of the FSA's Cost Benefit Analysis (CBA), especially the failure to estimate the loss to creditworthy borrowers who could not obtain a mortgage or who would be obliged to accept a smaller mortgage as a result of the proposed income-expenditure affordability test.[2] We are very pleased that the FSA has now, as part of this consultation, produced a far more considered CBA. Although disadvantaged by the absence of detailed data on borrowers' expenditure, the FSA has gone to considerable lengths to provide an impressive assessment of impacts – a vast improvement on the analysis in CP10/16. Also

[1] FSCP, "Six point plan for a sustainable and healthy mortgage market", June 2011 (http://www.fs-cp.org.uk/newsroom/2011/177.shtml)

[2] FSCP, "Response to FSA CP10/16 Mortgage Market Review – Responsible Lending", 16 November 2010. (http://www.fs-cp.org.uk/publications/responses/2010.shtml)

welcome is the FSA's willingness to re-assess policy in the light of any new quantitative evidence that may be provided by lenders.

The key policy points in our response are as follows:

- We support the FSA's attempts to mitigate against irresponsible lending in the mortgage market and the principles behind the proposals; in particular, we support income verification (granted a flexible approach to required documentation); new safeguards for interest-only mortgages (which we regard as a legitimate financial product for some consumers) and a strengthened regulatory approach, which should be implemented immediately, to firms' arrears management practices.

- In the light of the inherent uncertainty of the impact estimates and the conclusions of two independent Peer Reviews, commissioned by the Panel, of the FSA's welfare analysis, we have not relied on the FSA's central belief that its responsible lending requirements will prove "net beneficial in well-being terms". Instead, we have taken a more nuanced approach, recommending prudent and proportionate improvements where we believe the proposals need to be materially strengthened.

- The FSA should address the criticisms contained in the independent Peer Reviews of the welfare analysis before coming to final policy conclusions.

- We believe it is vital that the MMR proposals do not depress an already depressed housing and mortgage market and make life worse for indebted consumers. We make three recommendations: (1) the proposed interest rate stress test should be made more sensitive to market conditions; (2) unless the FSA is fully confident on the basis of solid empirical evidence that consumers would not be harmed by prompt implementation, the new responsible lending requirements should not be brought into effect until the housing market has demonstrably recovered; (3) the transitional arrangements should be considerably strengthened and applied immediately.

- We agree with the FSA that lenders should take fully into account consumers' committed and basic essential expenditure as a minimum when calculating affordability. Beyond that minimum, the Panel believes it should be for the lender to judge whether the consumer would be able to service the mortgage, if necessary by reducing discretionary expenditure. We make recommendations that would reduce the risk that the affordability requirements would unnecessarily and unfairly constrain responsible, creditworthy borrowers.

- The proposed definition of credit impairment and proposals regarding debt consolidation may prove overly restrictive. The FSA should conduct further work in this area to ensure that its proposals are balanced and evidence-based.

- There remains a danger of costly regulatory overlap between the conduct proposals in the MMR and the full range of macro-prudential interventions that the Financial Policy Committee might take to avert an unsustainable lending

boom. We repeat our recommendation, made in response to the 2010 MMR Consultative Paper, for further analysis to be led by the FSA. The FPC has also called for more public debate.[3]

- We similarly repeat our call for careful analysis of the wider social and economic implications of the MMR: for example, the implications for the unregulated buy-to-let market, the rental market and the market for social housing. The Panel is keen to see 'joined up thinking' on housing policy.

- We disagree with the FSA's proposal to abolish the non-advised sales route which would have the impact of extending regulated advice to the vast majority of consumers. We contend that many consumers are sufficiently knowledgeable to use intermediaries to acquire relevant information and then make their own choices without this needing to constitute regulated advice.

In the remainder of our preamble we expand on our key points, first in terms of areas of policy where we are broadly supportive and, second, other areas of policy where we still have some important concerns.

Areas where we are broadly supportive

Income verification

We support the FSA's proposals on income verification and believe a sensible and proportionate approach is being proposed. The Panel does not want to see a return to the types of problems, and consumer detriment, created by self-certified mortgages. All mortgage applicants should have their income verified as proposed, but lenders should be flexible about the form that independent verification can take. With the self-employed particularly in mind, lenders must become more astute in assessing applications.

Interest-only mortgages

We support the FSA's policy intention to limit the availability of interest-only mortgages to those consumers for whom they are suitable. The Panel believes that interest-only mortgages are a legitimate financial product for some customers, who may have a range of reasons for choosing one. As with other mortgage products, it should be up to the lender to judge affordability for the individual client. The lender must be able to explain with supporting evidence the rationale for such lending within the risk assessment process. We therefore agree that it is sensible to allow some flexibility when considering the provision of an interest-only mortgage.

The Panel has expressed concern in the past that the criteria for assessing ability to repay the capital on interest-only mortgages has become too relaxed, encouraging some groups of consumers to use these mortgages as a way of stretching affordability, without a realistic means of repaying the capital and, perhaps, without fully understanding the implications of this product.

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[3] Financial Policy Committee statement from its policy meeting, 16th March 2012.

Arrears

The Panel supports the FSA's proposals to strengthen its approach to firms' arrears management practices. This is an area with significant risk of detriment and hardship for consumers, especially in the current economic climate. Mortgage customers experiencing financial difficulty should be treated constructively and sympathetically, with solutions to managing arrears being developed on an individual basis, within a clear and transparent policy on arrears handling. Borrowers who have a reasonable chance of regularising their repayments should not be hindered from doing so by their lender, nor penalised with unfair charges that perpetuate the cycle of debt.

In addition we believe there is scope to further strengthen the rules on arrears charges, so that firms cannot create extra administration for the sake of increasing their own profits. It is not always apparent that extra administration serves any practical purpose to the lender or the consumer, yet there will be a 'reasonable calculation' of the actual cost of that extra administration. We would like to see it made clear that charges must also be 'proportionate and necessary' to prevent 'churning'. We believe such protection should be extended to all consumer mortgages in principle.

Other conduct issues

We are very pleased to see a number of the initiatives that the FSA sets out in its chapter of the consultation on 'Other Conduct Issues'. Our comments on arrears charges above highlight our concerns with some firms' behaviour in this regard and this appears to be by no means confined to arrears. Mortgage charges have been increasing in the market for some time as firms seemingly look for other ways to bring in revenue in the current low interest rate environment. For that reason we applaud the FSA's intentions to review this area and we would urge strong action against any firms found to be treating their customers unfairly in this regard. In order to do this, of course, the FSA needs to take a clear view of what constitutes 'unfair' and be prepared to act when treatment of consumers falls into this category.

Similarly, we would like to praise the FSA for its efforts in stamping out mortgage fraud and financial crime. While this is still a problem we believe the FSA has made great strides in recent times in identifying and fining those firms and individuals guilty of defrauding mortgage customers. We would expect the FSA to continue to act robustly in situations where misconduct is evident.

Finally, we are pleased that the FSA has agreed to monitor the activities of credit reference agencies in the mortgage market given the potential for multiple searches to have an adverse impact on a consumer's credit rating.

In terms of some of the potential scope extensions that the FSA discusses in this chapter we have some observations. On second charge the FSA notes itself the potential for 'gaming' the market should the stricter requirements the MMR proposes continue to be inconsistent with the regulation of these non-FSA regulated mortgages. Given that the transfer of second charge will not take place until April 2014 at the earliest we foresee this as a very real risk if the MMR is implemented any time soon. It is also the case that second charge lenders are often those who

are the quickest to force possession proceedings or act unscrupulously, another reason why regulation of this area should be made consistent with first charge lending as soon as possible.

Another potential scope problem the FSA identifies is that of buy-to-let mortgages. Again these are currently not regulated by the FSA. There is therefore considerable scope for individuals to take out such a mortgage without having any intention to use it as it is designed and to occupy the property themselves, given affordability criteria may be less stringent. While the decision whether or not to regulate this market is not one the FSA can make itself we note that the draft EU Mortgages Directive would bring buy-to-let into the FSA's scope, were it to be implemented as it is currently written. We make the point later in our preamble that we see benefit in delaying implementation of the responsible lending requirements[4]. The FSA should at least consider whether aligning that implementation more closely with the EU Directive would help avoid some of the potential confusion in the buy-to-let market.

Niche Markets

Given the level of vulnerability in some of these markets we are supportive of the tenor of the proposals in this regard, most of which read across from the core mortgage sector to these niche areas. The FSA will be aware that the Panel has long advocated that the lifetime mortgage market should be accessed on an advice-only basis so we are particularly pleased to see that our recommendation has been heeded, notwithstanding the fact that consumers will still have the facility to reject the advice once given with no need for further input from their intermediary.

With regards to how the FSA proposals apply to small businesses and high net worth individuals we are keen for the requirements to be made more flexible where appropriate, especially at a time when smaller firms face difficulty accessing sufficient finance. The elective approach has attractions subject to two provisos: the FSA should monitor the perimeter of the regulated market carefully to guard against regulatory arbitrage and mandate a sales process under which business borrowers are informed by the intermediary of their right to forgo MMR protections.

Areas where we have greater concerns

Cost-Benefit Analysis

As previously noted, the Panel is impressed by the FSA's response to our criticisms of the CBA in CP10/16. Enormous effort has clearly been expended on providing a detailed and searching analysis. The consultation notes that the CBA "has been unusually difficult to prepare."[5] We commend the FSA for attempting to meet that challenge.

Setting aside the details of the analysis, the Panel is firmly of the view that the requirement to conduct a rigorous CBA played a key role in the beneficial development of the FSA's thinking. CP10/16's highly prescriptive proposals that

[4] The FSA's collective term for the new affordability assessment, the interest rate stress and the interest-only proposals.

[5] Annex 1, A1, paragraph 4, A1:2. (Unless stated, references are to CP11/31.)

gave little consideration to creditworthy consumers have been replaced by a consultation paper focussed on the sometimes conflicting interests of different groups of consumers. The result is a much more considered and proportionate set of affordability proposals. The comparison between CP10/16 and CP11/31 shows the value of analysis of welfare trade-offs that well may be encountered more frequently under the regulator's new, more intrusive, agenda for consumer protection.

Despite general approval of the improved approach taken by the FSA, the Panel must nevertheless express strong reservations about the extent to which the CBA's key conclusion can be relied upon confidently to guide policy thinking. As noted by Lord Turner in his Foreword, the estimates are "inherently uncertain". Moreover, the Peer Reviews commissioned by the Panel cast considerable doubt on the soundness of the CBA's well-being analysis.

In our response to this CP, we have therefore not relied on the FSA's central belief that its responsible lending requirements will prove "net beneficial in well-being terms".[6] Instead, we have taken a more nuanced approach, recommending improvement where we believe the proposals need to be materially strengthened.

The impact analysis - that part of the CBA concerned with the number and type of consumers affected by the proposals[7] - is unfortunately compromised by the absence of data on borrowers' expenditure and of a clear definition of "hard-to-reduce living costs". To provide estimates, the FSA has been obliged to use approximate methods that incorporate, as is freely acknowledged, somewhat arbitrary assumptions. It is simply not known how closely these methods approximate the true impact of the MMR proposals.

The quality of underwriting estimation method, for example, is chosen because the FSA believes it helps to identify mortgages that were poorly underwritten, and asserts "these are the mortgages most likely to be affected by our proposals".[8] A specific underwriting risk score threshold is selected because it is midway between the point where "poor lending begins to be visible" and the "worst lender".[9] It would have been preferable to have chosen a method of estimation that assessed the impact of the affordability proposals as they would apply in practice, without the presumption that they effectively target poor lending practices.

The quality of underwriting method is not used to assess the incremental impact of the interest rate stress test and interest-only proposals. Instead, use is made of debt service ratio thresholds, a method that the FSA regards as less than ideal: "there is not a DSR cut-off that clearly corresponds to the point at which a mortgage becomes unaffordable."[10] A DSR threshold of 45% is chosen for the FSA's central estimates "based on a judgement about what might be a reasonable level for such a cut-off". It is acknowledged, "this is not a precise or an empirically-based threshold …"[11]

[6] Annex 1, A1, paragraph 18, A1:5.

[7] Annex 1, Sections A to G.

[8] Annex 1, A1, paragraph 7, A1:3.

[9] Annex 1, A4, paragraph 29, A1:35.

[10] Annex 1, A4, paragraph 73, A1:51.

[11] Ibid.

In the absence of the requisite empirical evidence, the Panel believes it would be unwise to place much weight on these results. We note that the DSR thresholds tested in this consultation are higher than those used in CP10/16 (30% and 35%), which gave much larger estimates of the impact of the then proposed affordability test.

In view of the great uncertainties, we welcome the FSA's call for more quantitative evidence on impacts, against which policy would be reassessed.

The CBA also includes a novel analysis of consumer well-being relevant to the Board's judgement regarding the balance of costs and benefits. As a result of the MMR's responsible lending requirements, some consumers gain (by being absolved from impairment) and some lose (by being denied full access to an affordable mortgage). Influenced by the CBA, the "... Executive and Board of the FSA have reached the judgement that the benefits enjoyed by the c.30% of affected borrowers who would otherwise get into payment difficulties outweigh the costs suffered by the 70% affected who would not have got into payment difficulties. This reflects the strong evidence of very significant stress caused by arrears and repossessions." [12]

The Panel welcomes the FSA's attempts to measure this key trade-off; as noted in our November 2010 response, the absence of such analysis was a major weakness of CP10/16.

To assess the robustness of the well-being analysis,[13] the Panel has sought the opinion of two independent specialists whose Peer Reviews are published with this response on the Panel's website.[14] These Reviews make a number of criticisms, including:

- Omission of alternative policy options:
  Established best practice, including that recommended by the FSA's own guidance on CBA methodology,[15] is to evaluate welfare under alternative policy options, which in this case should importantly have included different levels of stringency of application of the responsible lending requirements.

- Omission of sensitivity analysis:
  Established best practice is to test the robustness of welfare estimates to alternative assumptions, parameters and model specifications; according to one of the specialists: "Section H completely fails to recognise this need".[16]

- Unsatisfactory well-being methodology:
  The FSA's well-being approach is not clearly articulated and open to serious

[12] Annex 1, A4, paragraph 178, A1:79.

[13] Annex 1, Section H.

[14] Peer Reviews by Europe Economics and Jon Stern available at http://www.fs-cp.org.uk/publications/research_documents.shtml

[15] As set out, for example, in "The Green Book: Appraisal and Evaluation in Central Government", HM Treasury, 2003 plus updates http://www.hm-treasury.gov.uk/data_greenbook_index.htm and
"A Guide to Market Failure Analysis and High Level Cost Benefit Analysis", FSA, November 2006. www.fsa.gov.uk/pubs/other/mfa_**guide**.pdf

[16] Jon Stern's Peer Review, section 2.1.

challenge. Well-being analysis, while a useful supplement to other methods, is not generally regarded as sufficient on its own to establish the full range of welfare gains and losses. To improve the robustness of the appraisal, alternative methods (such as Stated Preference Modelling) should have been tried.

- Incomplete evaluation of spillovers:
  There is inadequate assessment of the welfare implications for a number of related markets, including those in private rented accommodation and housing construction.

- Absence of clear, future counterfactual:
  The retrospective well-being analysis does not evaluate the implications of improved prudential regulatory changes on the future net welfare impact of the MMR.[17]

- Lack of robustness:
  In general, the well-being analysis in Section H is seriously flawed; in the words of one of the specialists: "It does not provide a robust and well-founded set of estimates of the impact of the proposed MMR responsible lending requirements on the retail housing market or on its participants."

In its Six Point Plan, the Panel called for a robust CBA (point 1) and for regulatory policy changes that took account of both wider social and economic implications (point 2) and the interaction between prudential and conduct regulations, lest consumer welfare be reduced by unintended and costly regulatory overlap (point 5).

Based on our assessment of the impact analysis and the views of the CBA welfare specialists, we conclude that these points have not yet been satisfactorily addressed.

We strongly recommend that the FSA respond to the criticisms contained in the Peer Reviews before coming to its final policy conclusions.

The need to avoid depressing a depressed market

The consultation rightly notes that the "impact of the MMR is highly likely to be cyclical, with higher impacts during a housing boom and lower impacts during a more subdued housing market."[18] The restraining effect of minimum regulatory requirements is naturally greater in a boom, when lenders' underwriting standards relax, than in a slump, when lenders' risk aversion prompts a tightening of underwriting standards.

[17] Europe Economics Peer Review, paragraph 3.9. We note that the FSA's impact analysis considers the effect of improved micro and macro prudential regulation, drawing the conclusion that "lending is also likely to fall more for higher-risk borrowers" (Annex 1, A4, paragraph 131, A1:68). In a related footnote (footnote 31, A1:68) , the FSA nevertheless asserts "It is our view that …. there is a strong case for the MMR.", drawing attention to the assessment of Basel III in Chapter 8. The well-being analysis does not, however, assess whether the "hit rate" remains above the "tipping point" in all states of the housing market under a future counterfactual that includes Basel III and the full range of likely macro-prudential instruments.

[18] Annex 1, A2, paragraph 8, A1:12.

Provided the measures are proportionate, consumers may well benefit from the greater restraint on lending naturally exerted by the MMR's key proposals during an unsustainable boom. Lax underwriting standards during the last housing market bubble led to irresponsible lending and much consumer detriment. Averting such outcomes would be highly desirable, as Lord Turner argues in his Foreword to the consultation. Indeed, we believe the MMR's responsible lending proposals could be strengthened by making them even more contra-cyclical, and co-ordinated with the macro-prudential policy stance of the Financial Policy Committee.

Although smaller than the impact during a boom, the restraint on lending that would be exercised by the MMR's proposals during depressed market conditions is, by contrast, unwelcome.[19] In depressed conditions, the risk of irresponsible lending is low, precisely because underwriting standards are tight. The Panel is concerned that such impact as the MMR's key proposals may have on lending in today's market conditions would penalise creditworthy borrowers, with little offsetting benefit in terms of avoided impairment: high-risk borrowers cannot in any case obtain mortgages from risk-averse lenders.

To use the terminology of the CBA, in depressed market conditions the "hit rate" – the proportion of affected borrowers who would have faced impairment – may well fall below the "tipping point" at which consumers' collective well-being would be raised by the MMR proposals.[20] The result would be net consumer detriment.

In addition, a set of policies that would helpfully protect consumers should a housing bubble threaten may unwittingly license and encourage excessive caution by both borrowers and lenders in depressed, post-bubble conditions. Behavioural biases, such as the momentum behaviour identified in the MMR's market failure analysis, work in both directions.[21] Excessive caution by lenders could prove as damaging to consumer welfare in the downswing as excessive optimism in the upswing. In current market conditions, the FSA needs to be alive to the danger of damaging fragile sentiment.

To reduce the risk of detriment, and to strengthen the contra-cyclicality of the MMR proposals in the interests of consumers, the Panel makes three recommendations:

1. The minimum interest rate increase applicable under the interest rate stress test should be adjusted counter-cyclically to lean against the cycle in mortgage underwriting standards. In depressed market conditions, when

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[19] The FSA's impact analysis suggests that 2.5% of borrowers in the subdued market conditions experienced in 2009 and 2010 would have had their mortgage application denied or reduced in size as a result of the combined impact of the proposed affordability assessment, the interest rate stress test and the interest-only proposals. This assessment assumes that 90% of lenders in subdued market conditions would apply an interest rate stress test compliant with the FSA proposals. Without that assumption, the incremental effect of the stress test over and above the affordability test alone would rise from 0.25% to 2.5%. (Inferred from Annex 1, A4, paragraphs 77-78, A1:52.)

[20] The FSA's impact analysis suggests a "hit rate" of 7% in the subdued period, although it is argued this figure may be an under-estimate (Annex 1, A4, paragraphs 115-116, A1:65; also Annex 1, A4, Table A4.5, A1:72). The FSA's well-being analysis puts the "tipping point" at around 20-22% (Annex 1, A4, paragraph 4, A1:27.) The stated hit rate is below the tipping point in the subdued period. The precise figures are subject to considerable uncertainty, not least because of changing conditions in the mortgage market. Our recommendations are based on the need to reduce the clear risk of unintended regulatory detriment during depressed market conditions.

[21] Annex 1, A3, A1:19. The Peer Review by Europe Economics of the FSA's well-being analysis develops this point in terms of consumer behaviour.

underwriting standards are already very tight, the minimum should be set to zero. In incipient bubble conditions, by contrast, when there is a danger of overly lax underwriting standards, the minimum could be set much higher than the 1% proposed. The decision on the appropriate minimum should be taken by the FSA (and future Financial Conduct Authority) partly in the light of, and co-ordinated with, the macro-prudential policy stance of the Financial Policy Committee.

2. Unless the FSA is fully confident on the basis of solid empirical evidence that consumers would not be harmed by prompt implementation, the new responsible lending requirements should not be brought into effect until the housing market has demonstrably recovered. The recommendation to delay gels with the FSA's intention to "have regard to market conditions "and to "defer implementation if that proves necessary". Delayed implementation should not obstruct, and may aid, the definition and prior announcement of clear regulatory rules, to the benefit of both lenders and consumers.[22]

3. The transitional arrangements should be considerably strengthened and the plight of mortgage prisoners rapidly addressed. These protections should be applied immediately.

Further details of our thinking on the stress test and transitional arrangements are given below.

Transitional arrangements

We have previously made the point that the FSA needs to ensure transitional arrangements adequately provide for consumers who have historic mortgages that may now lie outside the responsible lending criteria.[23] Undoubtedly, as the consultation indicates, there are potential risks in the transition to the new rules to 'mortgage prisoners' – borrowers who are 'trapped' with their current lender. The risk of being charged a higher interest rate because a consumer is unable to move their mortgage elsewhere is particularly acute. This applies both to borrowers who are already trapped, because they do not meet current tightened lending criteria, and those who may be trapped in the future following implementation of the MMR.

The FSA has recently issued guidance under the Unfair Terms in Consumer Contract Regulations which reminds firms about some of their responsibilities in this regard. However, we are not convinced that these powers, and the additional requirement for firms to treat their customers fairly, are sufficient to mitigate the situation above. The consultation highlights how "the transitional arrangements will not compel the lender to lend, even where the borrower meets the relevant conditions. Whether to lend is a commercial decision for a lender to make."[24]

[22] Overview, paragraph 1.18, 14. With regard to developing European legislation, we agree with the FSA that the MMR should not be delayed "because of the possibility of European changes" (Chapter 2, paragraph 2.36, 48), but we note that delayed implementation on the grounds we propose may provide the FSA with an opportunity better to align the MMR and the European mortgage credit directive.

[23] Point 4 of the Panel's Six point plan (ibid, footnote1).

[24] Chapter 3, paragraph 3.354, 115.

By offering firms the flexibility in this regard it is our view that the rules do not go far enough. Our response to Question 16 offers an alternative solution to this issue. We suggest a specific rule to ensure that consumers impacted by the transitional arrangements are not unfairly treated or discriminated against by reason of their inability to access alternative, more competitive mortgage products.

Responsible lending & borrowing

As previously noted, the Panel welcomes the FSA's decision to drop the concept of "free disposable income" proposed in CP10/16 and the related proposals to restrict to 25 years the maximum assessable mortgage term and to impose an extra buffer in the assessment of the credit impaired. The 25-year and credit-impaired proposals did not properly allow for people's increased longevity, changing working patterns and circumstances. Similarly, the decision to allow for lending into retirement as long as it is 'prudent and proportionate' is in our view appropriate.

We especially welcome the FSA's recognition of consumers' ability to manage their finances, reducing ("flexing") their spending when in financial difficulty and giving priority to the repayment of the mortgage. CP10/16 doubted whether consumers would flex their spending when "overtaken by the demands of real life."[25]

The Panel agrees with the spirit of the CP11/31 proposal that lenders should "as a minimum" take fully into account consumers' committed expenditure and other non-discretionary spending. Beyond that minimum, the Panel believes it "should be for the lender to judge whether the consumer would be able to service the mortgage, if necessary by reducing discretionary expenditure".[26] Were the regulatory minimum more restrictive, consumers who fully intended to reduce their discretionary expenditure to pay off their mortgage would be unfairly penalised.

We applaud the FSA's attempts to make the distinction between non-discretionary and discretionary spending operational, prescribing categories of spending that comprise "basic essential expenditure" and providing guidance of what may comprise "basic quality-of-living costs". But there are considerable difficulties with these definitions, which may very easily stray in implementation to include large parts of consumers' flexible discretionary expenditure, causing unnecessary detriment to responsible, creditworthy borrowers. We explore this issue in more depth in our response to the affordability questions.

Credit impaired consumers

We feel that the FSA's proposals regarding credit impairment fail to recognise the dynamics of indebtedness and may not be sufficiently targeted to protect those who are most at risk. The proposed definition of credit impairment may prove overly restrictive and could inhibit recovery among those who are moving out of a period of financial difficulty. In addition, while we recognise that there has been widespread bad practice in the issuing of debt consolidation loans in the past, we are concerned that the current proposals will limit access to this finance for people for whom it is a legitimate response to financial difficulty. We encourage the FSA to conduct further

[25] CP10/16, Chapter 2, paragraph 2.40, 22.

[26] FSCP, "Six point plan for a sustainable and healthy mortgage market", June 2011.

work in this area to ensure that its proposals are balanced, evidence-based and grounded in the reality of consumer experience.

The interaction between the FSA's conduct proposals and the macro-prudential policies the Financial Policy Committee may adopt to deal with an emerging property bubble

Chapter 8 of the consultation provides a helpful explanation why the FSA believes Basel III is not on its own an effective mechanism to address the high-risk lending that the conduct proposals in the MMR are trying to target, and therefore why those conduct reforms are needed.

We have previously outlined our own concerns about the costs and impact of overlapping regulations. In our response to CP10/16 we made the point that "A balance has to be found between the regulation of the prudential and conduct of business sides of the mortgage sector. We believe either the Bank or the FSA – and preferably the FSA as a consumer guardian – should take the lead in fully considering the extent to which the MMR's conduct of business proposals will interact with, or duplicate, the impact of measures taken by the prudential regulator, in particular the counter-cyclical macro-prudential interventions by the Financial Policy Committee (FPC)."

We are pleased that the FSA has looked at this issue in the context of Basel III but greater consideration still needs to be given to the full range of potential macro-prudential interventions the FPC might make, and their interaction with the conduct proposals in the MMR, as we outlined in our earlier response. Our recommendation gels with advice recently given by the FPC to HM Treasury that the statutory FPC should not currently take powers of Direction over loan to value and loan to income restrictions but that their use should be considered "after further analysis, reflection and public debate."[27]

We note the FSA's conclusion that "additional reforms on the conduct of business side are required to reduce the risk of consumer detriment in the mortgage market due to relaxed lending standards and over-rapid credit expansion in a *boom period*" (our emphasis).[28] As noted previously, the Panel concurs provided the measures are proportionate: consumers may well benefit from the greater restraint on lending naturally exerted by the MMR's key proposals during an unsustainable boom.

However, the balance of welfare gain *outside* of bubble conditions is not satisfactorily addressed by the FSA's analysis, either in Chapter 8 or in the CBA. As noted previously, we have not relied on the FSA's central belief that its responsible lending requirements will prove "net beneficial in well-being terms", and have made recommendations to strengthen the proposed measures in different states of the mortgage market: depressed, normal and unsustainable boom.

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[27] Financial Policy Committee statement from its policy meeting, 16th March 2012, page 5.

[28] Chapter 8, paragraph 8.5, 209.

A co-ordinated housing policy

We would like to be assured that the FSA has taken full account of the wider social and economic implications of the MMR. We indicate above how we are pleased some of the previously overly prescriptive proposals have been relaxed. However, the MMR proposals could still have serious implications for the unregulated buy-to-let market, the rental market and the market for social housing. The Panel is keen to see 'joined up thinking' on the MMR and its wider implications for housing policy. We are not convinced that serious enough consideration has been given to what action the Government might need to take in light of the potential changes to the home-ownership population brought about by the MMR.

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In our response to the FSA's earlier consultation in this area (CP10/28) we were generally supportive of what the FSA set out. However, we note a number of significant changes since that consultation, principally around the new proposal to classify all spoken and interactive dialogue as advice. This will effectively lead to the vast majority of all mortgage sales and variations of contract becoming advised. We also comment below on the abandonment of the requirement for advisers to adopt the same labels as those being introduced via the Retail Distribution Review (RDR).

In our earlier MMR responses we acknowledged the fact that there are some consumers who are sufficiently knowledgeable to use the non-advised sales route to receive information on products that are available and then make their own choices. We continue to believe this is the case and this is one of the reasons why we fundamentally disagree with the FSA's revised approach..

The FSA argues under its revised proposals for the removal of the non-advised sales route primarily because research findings show that consumers do not understand the difference between non-advised and advised sales, and instead just assume that they have been given 'advice' whichever route was chosen. Although we agree on that point we do not believe that classifying all spoken and interactive help and information a consumer may receive through the buying process as 'regulated advice' is the answer. This is far too broad a definition and will mean that many consumers seeking only a piece of information will be pulled into an advised process.

The distinction between what constitutes giving 'information' and what is considered to be helping someone come to a decision is vague enough that for the sake of regulatory certainty we doubt many firms will offer any alternative to 'regulated advice'. For this reason we believe the FSA's revised proposals are misguided.

For what are in effect lower risk products – compared to most investments – many consumers can make an informed choice about what they are looking for, but still need help with product features, terms and conditions and providers. This is why the 'non-advised' route has generally tended to work relatively well in the mortgage market and why it was introduced in the first place. Thus, while we agree that most consumers do need help and support through the buying process that should not necessarily have to constitute 'regulated advice'.

It is therefore particularly disappointing that despite the overwhelming majority of respondents to CP 10/28 (including the Panel) being in favour of continuing allow consumers to get a mortgage without advice the FSA has changed its stance (notwithstanding the opt-out the FSA allows for at the end of the process).

The consequences of the FSA's revisions are that those customers who do not want or need a specific recommendation – which in reality is likely to include the majority of second and third time buyers along with those who are re-mortgaging – but still need to interact with the lender to find out details of the terms and conditions relating to a specific mortgage, will now be classified as receiving 'regulatory advice'. Equally, those people who go to an intermediary to find them the best fixed rate deal on the market (rather than to assess whether a fixed rate deal is appropriate) will be forced through the advised route, as they will be having 'spoken or interactive dialogue', as will anyone who makes even the most minor variation to their existing mortgage contract. We contend that this is not an improvement on the existing regime but rather an example of over-regulation which is likely to increase transactions costs.

We therefore see little reason to change the current rules in this regard other than to tighten up the requirements for particularly vulnerable groups. We agree with the FSA that advice should be required for right-to-buy and the credit impaired, for instance. In addition we also agree that advice should be mandatory for individuals taking out equity release or sale and rent back products. It may, in addition, be possible to strengthen the requirements for first time buyers, who will eventually re-enter the market in greater numbers, so that firms evidence that these buyers have demonstrated due diligence during the transactions process, rather than to subject them to mandatory advice. Furthermore, the FSA could strengthen the information provided to the consumer on both non-advised and advised sales, or to allow execution-only with access to help and information for those that prefer that route.

In terms of the labelling issue we have previously agreed that limiting the descriptions of advice, to bring them in line with the RDR labels of 'independent' and 'restricted', would offer a clearer understanding of those services being provided. However, we accept some of the concerns raised around these labels – that a variety of other terms might more appropriately describe the service distinction or that the term 'restricted' could be misinterpreted as a description of the quality of advice rather than the range of products. Therefore, the compromise proposal that where the intermediary services a limited range of providers they will be required to inform the consumer of the number or the names of those providers appears appropriate.

We still agree with the intention to apply common professional standards across the mortgage market but, given that Qualification and Credit Framework (QCF) Level 3 should not be a particularly difficult standard to reach, also feel that Level 4 should be the longer-term goal. The latter is equivalent to the standard required of investment advisers under the Retail Distribution Review. Allowing Level 3 advisors to continue to operate in the mortgage market could conceivably attract advisors to this market who were not capable of achieving the higher requirements for investment advice. We therefore believe the FSA should monitor the implications of this decision closely.

Responses to the questions

Q1: Do you agree that lenders should detail how they incorporate anti-fraud controls into their affordability assessments in their responsible lending policy?

Given that the existence of mortgage fraud continues to be a major issue of concern in the UK mortgage market we believe it should be a requirement for lenders to have to comply with such a proposal. This would mean that firms would have to be explicit about the fraud controls they have in place and make sure that their Boards have full oversight of such controls.

Q2: Do you have any comments on our income proposals?

We agree that all mortgage applicants should have their income verified and that fast-track and self-certified mortgages are no longer viable. We also contend that lenders should be flexible about the form that independent verification can take, so that different income models such as the self-employed are recognised. On that basis we agree with the FSA's proposals with the lender taking responsibility for verification in every case.

Q3: Do you agree with this approach to expenditure? Do you have any comments on the categories of expenditure? Do you have any practical concerns about implementing this approach?

The Panel agrees that lenders should be rigorously assessing a customer's ability to repay a mortgage. This will protect consumers, especially those who are vulnerable, from entering contracts that are unaffordable. We previously indicated how we felt the earlier proposals, to mandate affordability assessments on a prescriptive list of specified areas, were overly onerous and did not take adequate account of consumers' ability to change their patterns of expenditure.

We indicate in our preamble that we agree with the spirit of the CP11/31 proposal that lenders should "as a minimum" take fully into account consumers' committed expenditure and other non-discretionary spending. Where we consider there are difficulties with the revised approach is the potential for the definitions to stray in implementation to include large parts of consumers' flexible discretionary expenditure, causing unnecessary detriment to responsible, creditworthy borrowers.

As the FSA's own extensive statistical investigations confirm, it cannot be determined that all spending on, say, clothing, furniture or household appliances is non-discretionary rather than, in part, discretionary. Whether spending can be reduced easily or only with difficulty is similarly imponderable: the answer will depend on individual circumstances and preferences. Even spending that falls within the category of "basic essential expenditure" may be flexed to some degree.

Moreover, the subtle distinction between, say, "basic recreational activities" and discretionary spending on cheap holidays or between spending on "non-essential transport" and discretionary spending on train and bus journeys may not survive lenders' standardisation of their appraisal processes.

To avoid undesirable restrictions on responsible consumers, the Panel proposes two possible options:

1) That the regulatory minimum requirement should comprise only committed and basic essential expenditure. Under this option, the FSA's additional category of "basic quality-of-living costs" would not be included as a minimum regulatory requirement, although the lender would be judging, from a robust assessment of the applicant's ability to pay, what other types of spending it would be appropriate to take into account.

2) As with 1) but with the lender also required to add a minimum additional percentage to committed and basic essential expenditure for "basic quality-of-living costs". This minimum should be set at a deliberately low level, such as 5%. The precise figure could be refined if better evidence emerges, recognising the need for a certain standard of living, which it would be extremely difficult to flex.

We, of course, expect the FSA to monitor rigorously lenders' application of its rules, to challenge firms who have a poor underwriting record, and to be especially mindful of the tendency for lending standards and the vigour of regulatory oversight to slip should the housing market once again boom.

Q4: Do you have any comments on our proposed approach to assessing affordability against future interest rate increases?

The Panel agrees with the FSA's aim to "help prevent the granting of loans that are affordable when rates are low but predictably unaffordable when rates rise."[29] We believe that it is perfectly reasonable for lenders to be required to take account of the impact on mortgage payments of market expectations of future interest rate changes.

However, as previously noted, we are concerned that the interest rate stress test may prove overly restrictive in subdued market conditions, when underwriting standards are already tight, and insufficiently restrictive in boom market conditions, when underwriting standards loosen. We therefore recommend that the minimum interest rate increase required under the stress test is varied contra-cyclically: set at zero in depressed market conditions and potentially set much higher than the proposed 1% in bubble housing market conditions. The decision on the appropriate minimum should be taken by the FSA (and future FCA) partly in the light of, and co-ordinated with, the macro-prudential policy stance of the Financial Policy Committee.

The Panel also believes that lenders should take into account factors other than interest rates that bear upon the borrower's ability to repay, including income prospects. Current market expectations of future interest rate increases are partly based on the presumption that bank rate will be raised by the Bank of England as the economy recovers. Recovery itself would likely improve income prospects for borrowers in general. The MMR would have an unduly restrictive impact were the proposals to lead lenders to take into account only the rise in interest rates rather than, in addition, the associated general recovery of incomes.

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[29] Annex 1, A4, paragraph 53, A1:44.

This point has a bearing on the Guidance within the draft rulebook. Firms are required under draft rule 11.6.12 to take account of future changes to a customer's income and expenditure but the accompanying guidance 11.6.13 is solely concerned with developments that would adversely affect the customer's ability to repay.

The Panel believes that the Guidance should be even-handed and emphasise in addition possible positive developments, such as the impact on the customer's future income of career progression or of economic recovery in general.

If all the main factors that bear upon prospective affordability – future income, expenditure and interest rates – are taken into account in a considered and symmetric fashion, there would be less risk of the MMR' s affordability tests preventing genuinely creditworthy consumers from obtaining the mortgage they want. At the same time, desirable safeguards against unaffordable lending would be preserved.

Q5: Do you agree with our assumption that 90% of lenders already apply a stress-test?

We do not have any data in this regard so are unable to respond to this question.

Q6: Do you think that lenders are currently applying a stress test of a similar degree to the test we propose?

We do not have any information which indicates the nature of lenders' current stress testing.

Q7: Do you have any comments on our proposal to drop the requirement that affordability should be assessed on a maximum term of 25 years?

We are fully supportive of the decision to drop this particular requirement. Changes in demographics and living patterns mean that mandating a maximum term would cause unnecessary consumer detriment..

Q8: Do you have any comments on our proposals to protect credit-impaired consumers?

We agree that the earlier proposal to introduce a 'buffer' for credit impaired consumers was inflexible and would restrict the access of the credit impaired to the mainstream market, forcing them to borrow from other more expensive or unscrupulous sources. We agree that this proposal was therefore unnecessary and that it should be dropped.

Q9: Do you think that our proposed enhanced sales standards will provide adequate protection for right-to-buy consumers? Are further measures required?

We do not have a great deal of expertise in this area and the FSA should be guided by what others might have to say, such as the Money Advice Trust and Shelter. However, we do believe extra care needs to be taken given the potential for right-to-

buy consumers to be vulnerable. Supervisors should take a focused view of this part of the market to avoid any potential exploitation of right-to-buy customers' circumstances.

Q10: Do you think income multiples could work under our proposed rules? If not, why?

Ideally we would prefer that the lender take account of other indicators of affordability rather than just solely using a multiple of income, which can be a crude measure and is not always indicative of an individual's ability to repay. However, we have no objection to the continued use of income multiples as one means of assessing the maximum loan for which a consumer may be eligible, provided that the lender can evidence that the loan is affordable.

Q11: Do you have any comments on our proposal to require lenders to take into account information about future changes to income and expenditure?

As noted in our response to Q4, the Panel would expect lenders to take broadly into account future developments in income and expenditure (together with interest rates) in a considered and symmetric fashion. We agree that it is unrealistic to expect lenders accurately to predict all future events. Lenders should instead be required to use their best endeavours to take account of clearly foreseeable events (such as retirement) while adding a broad allowance for other factors, such as the customer's career prospects or the state of the economy. Lenders should be sophisticated enough to allow for the likelihood of negative income shocks as the economy enters recession and of positive income surprises as the economy recovers.

To help ensure that the assessment of future prospects is symmetric and even-handed, the FSA's Guidance needs to be amended to emphasise the possibility of positive future income developments as well as the negative developments with which the current draft rulebook is solely concerned. To the draft guidance at 11.6.13 (1), the following could be added:

"Positive income developments that should be taken into account include those likely to arise as a result of the customer's career progression and, more generally, from improved economic prospects, including the strength of the labour market."

On the specific question of retirement, the Panel agrees with the requirement that lenders be 'prudent and proportionate. Lending into retirement will not necessarily become problematic and many older consumers will have perfectly adequate means to support payments, such as employment, pensions or savings.

Q12: Do you agree, that to ensure these proposals work, we should define a credit-impaired consumer? Do you agree with our proposed definition?

We support the intention to define the credit impaired, but this needs to be clear in order to strike the right balance and avoid including or excluding the wrong groups of consumers. The definition also needs to be sensitive to the dynamics of indebtedness recognising that, for some, debt consolidation could result in a further deterioration in financial circumstances while, for others, it will be a valid and legitimate route to a more stable financial situation. In particular, we are concerned

that too restrictive a definition would limit access to mortgage finance for those who are moving out of a period of financial difficulty and could inhibit recovery from indebtedness. We would strongly encourage the FSA to work closely with consumer groups, researchers and academics who can offer insights into financial difficulty and credit impairment to develop a clearer, evidence-based understanding of the risks associated with this group and ensure that the definition is workable, appropriately targeted and likely to be successful in protecting credit impaired consumers.

We are concerned that the proposed definition of credit impairment may prove overly restrictive. As drafted, it would include people who have missed the equivalent of three months' payments on a mortgage or other loan in the last two years. We believe that the definition should be amended to include only people who have missed payments over three *consecutive* months, rather than simply an amount equivalent to three months. This amendment would make it more likely that the definition will capture people with more serious and sustained financial difficulties, rather than simply those who have experienced occasional difficulties.

If the FSA decides to retain the definition currently proposed we believe that the time period that applies should be reduced from two years to one year. This would reduce the risk of capturing people who are recovering from a period of financial difficulty. In addition, we suggest that it may be more appropriate to define the credit impaired as those who meet at least two out of the three FSA criteria at paragraph 3.321 rather than just one as is currently suggested.

The FSA should also consider including a 'right of appeal' so that any consumer inaccurately caught by the definition might be allowed the opportunity to challenge that classification given its implications for their mortgage application.

Q13: Which option do you prefer? Option 1, where the lender would be required to take reasonable steps to ensure that debts to be consolidated are repaid? Or option 2 where the lender would be required to assume that debts to be consolidated remain outstanding for purposes of assessing affordability? If you disagree with both options, what do you suggest as an alternative?

We have concerns about both of the options proposed.

In principle, we are supportive of Option 1 in respect of credit impaired consumers but are very concerned that the practical difficulties associated with implementing it would limit the options for debt consolidation for this group. We see this as a very undesirable outcome for people for whom debt consolidation represents a valid solution to financial pressure.

We are strongly opposed to Option 2 as we believe this would exclude the majority of credit impaired consumers from access to mortgage finance for debt consolidation.

We feel that the FSA currently lacks the necessary knowledge and evidence base to construct suitable proposals around debt consolidation loans for the credit impaired. In particular, there is a lack of evidence on instances where debt consolidation has

worked well for consumers. Much of the evidence that does exist comes from advice agencies that generally see people for whom debt consolidation has not had a successful outcome. We encourage the FSA to conduct further work in this area, including some consumer research and liaison with informed stakeholders, to better understand the needs and risks associated with credit impaired consumers. Given the vulnerability of this group to both overly lax and unnecessarily restrictive regulatory requirements it is critical that the FSA develops proposals that are evidence-based and grounded in the reality of consumer experience.

Q14: Do you agree with our proposals to strengthen lender's systems and controls around responsible lending?

We welcome all of these proposals, in terms of the revised requirement for a responsible lending policy, new record keeping requirements and more requirements for firms' internal compliance monitoring processes. However, we would also expect the FSA to itself be monitoring lenders' behaviour through supervisory visits and thematic work and to challenge those firms who show they are not complying with these rules.

Q15: Do you have any comments on our proposed transitional arrangements? Do you think they will be sufficient to address risks to consumers? Will they create any additional risks to consumers?

It is imperative that transitional arrangements adequately provide for consumers who have historic mortgages that may now lie outside the responsible lending criteria. The FSA makes the point in its consultation that lenders have already tightened their lending criteria following the market downturn. As a result, first time buyers are finding it difficult to get mortgages and existing mortgage holders are finding it difficult to move elsewhere.

The MMR will potentially exacerbate this situation and increase the number of mortgage 'prisoners'. In particular, there will be some existing borrowers who will be unable to remortgage to obtain a better deal, despite the fact they require no extra borrowing and their personal circumstances have not changed since taking the original mortgage. We are not convinced that the measures the FSA proposes prevent these types of consumers being charged a higher rate of interest by their lenders precisely because they are unable to remortgage elsewhere.

Some providers have shown previously how a disregard for the principle of 'treating customers fairly' does not necessarily have implications for their balance sheet and the Unfair Terms in Consumer Contracts Regulations (UTCCRs) are untested in this area. While we acknowledge the difficulty the FSA faces in transitioning to the new requirements, we feel that the additional risks to potentially trapped mortgage holders are such that other methods of dealing with this problem need to be considered

Whatever transitional arrangements apply, timing will also be crucial: there is a danger that lenders will reject mortgages which they view as not complying with the MMR and so further restrict consumers' options during a period of general lending restraint. Unless the FSA is fully confident on the basis of solid empirical evidence that consumers would not be harmed by prompt implementation, the new

responsible lending requirements should not be brought into effect until the housing market has demonstrably recovered.

Q16: Do you think that there is sufficient protection for mortgage borrowers who are 'trapped' with their current lender? If not, what additional protection do you suggest?

As we indicate above we are concerned that the level of protection for such borrowers might not be sufficient. The FSA has shown itself to be unwilling to enforce the Treating Customers Fairly principle where there is no other evident breach of the rules, and while the UTCCRs have been used in the past where lenders have made 'unfair' changes to interest rates this is a slightly different situation. For instance, when a consumer's fixed term deal comes to an end it is standard practice for that consumer's mortgage to be moved to, what is often a more expensive, Standard Variable Rate (SVR). This is legitimate practice and unlikely to contravene the UTCCRs. However, it could potentially work out to be significantly more expensive for a consumer and, if unable to move to another mortgage product, that consumer could find themselves 'trapped' in a difficult situation.

We therefore suggest a specific rule to protect 'mortgage prisoners', given that these consumers who become 'trapped' with their current lender are particularly vulnerable as the usual market forces of competition and consumer choice will not apply to them. In order to ensure that such consumers are not unfairly treated or discriminated against by reason of their inability to access alternative, more competitive mortgage products a new rule would have to define the category of 'trapped' mortgage customers. It would then include a provision which prohibited lenders from treating such consumers less favourably than other mortgage customers by reason of the fact that they were 'trapped'. The policy objective would be to prevent detriment in the first instance, as well as providing a remedy where necessary.

In order for this rule to be effective we would also require changes to be made to other rules. Specifically, we believe the overall transitional protection provided by MCOB rule 11.7.1R is discretionary. This rule uses the words *'a firm* need not apply', which is permissive and would mean that a lender could choose to apply the new MMR affordability test even though a customer enjoyed transitional protection in principle. It is our view that this is insufficient protection. We would urge the FSA to ensure that the transitionals provide much stronger protection for consumers and in this instance we call for the 'need not apply' provision to be changed to *'a firm* must not apply'. The effect of this change will be to prevent firms from disapplying the transitional protection when considering a new mortgage application from a customer who otherwise qualified for transitional protection.

Our other concern in this regard is that lenders could potentially use 11.7.1R (4) to circumvent the transitional safeguards. We argue above that lenders may well be reluctant to keep on, or accept as transfers, mortgages that are non-compliant with the new MMR rules. The way that this rule is currently phrased means that the very fact that these mortgages are non-compliant could be taken to imply that condition 11.7.1R (4) is not met and therefore that the lender is absolved from having to comply with the transitional arrangements. Our preference in this regard would be to delete paragraph (4). The rest of this transitional rule already requires the consumer

not to have been in arrears or had a payment shortfall within the last year, and also that the new product is no more than the same level of borrowing, and on no greater payment terms etc. Therefore we argue paragraph (4) serves no additional purpose as there is no obligation on a lender to lend, and there is sensible lending criteria built into this rule already.

As we highlight in our preamble we believe that unless the FSA is fully confident on the basis of solid empirical evidence that consumers would not be harmed by prompt implementation, the new responsible lending requirements should not be brought into effect until the housing market has demonstrably recovered. Moreover, we believe the transitional arrangements should be considerably strengthened along the lines described above. The potential for a further restraint on lending that would be exercised by the MMR's proposals at a time when underwriting standards are tight would be unwelcome. Given the FSA makes the point itself that it should "have regard to market conditions " and "defer implementation if that proves necessary"[30] we believe that, provided the measures are proportionate, consumers would be more likely to benefit from the greater restraint on lending naturally exerted by the MMR's key proposals during an unsustainable boom. In such a scenario our proposals to strengthen the transitional arrangements would thus be beneficial.

Q17: Do you think the eligibility requirements are appropriate? Should we allow these transitional arrangements to be used where the new monthly payment is higher?

On the whole we agree that the eligibility requirements are appropriate for the transitional arrangements, subject to our response to Q16 above and the position of interest only customers. We believe, however, that consumers should be given the choice of choosing a more expensive rate should they wish to do so, especially as in the case of a fixed rate deal at the time of rising interest rates it might be more beneficial to them in the long run to do so.

Q18: Should we allow the transitional arrangements to be used where there is a material change to the mortgage, such as the removal of a borrower following a divorce? How could gaming be prevented?

If a material change to a mortgage did not put the borrower in a worse financial position we see no reason why such a change should not be allowed under the transitional arrangements. Any change which had an impact on affordability should be treated separately in order to prevent gaming.

Q19: Do you think these arrangements will be practical to implement? How could they be improved or simplified?

We outline at Q16 above how we believe the current proposals could be strengthened.

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[30] Overview, paragraph 1.18, 14

Q20: Do you agree that the draft rules on responsible lending in the draft Mortgage Market Review (Conduct of Business) Instrument 2012, at Appendix 1, reflect the stated policy intention?

We do not agree that these rules reflect the stated intention, certainly with regards to the transitional arrangements, as we outline above at Q16. In our answer to that question we have proposed a workable alternative. In our response to Q11, we propose changes to the draft guidance at 11.6.13 (1).

Q21: What is your view on our approach to assessing affordability for interest-only mortgages?

We would like to see a regulatory environment emerging from the MMR that supports responsible lending of interest-only mortgages to informed consumers, but one which also protects consumers from unfettered future growth in this area of the market. The Panel believes that interest-only mortgages are a legitimate financial product for some customers, who may have a range of reasons for choosing one. We agree that it is sensible to allow some flexibility when considering the provision of an interest-only mortgage.

The Panel has expressed concern in the past that the criteria for assessing ability to repay the capital on interest-only mortgages has become too relaxed, encouraging some groups of consumers to use these mortgages as a way of stretching affordability, without a realistic means of repaying the capital and, perhaps, without fully understanding the implications of this product.

We therefore agree with the FSA's proposal that, as a general rule, mortgages should be assessed on a capital and interest basis. However, we consider it important that where a consumer has a clearly understood and credible strategy to repay the capital at the end of the term, affordability should be allowed to be assessed on an interest-only basis.

Q22: Do you agree that we should apply a consistent approach to regulating interest-only across the board and that we should not adapt our approach according to different consumer types?

We agree that applying a consistent approach is sensible and that it makes practical sense not to classify consumers for regulatory purposes, due to the wide variation in their circumstances. When assessing affordability an individual assessment of consumer circumstances is far more important than defining broad consumer types.

Q23: Do you agree with our non-prescriptive approach to repayment strategies, or do you have any comments on this approach?

As with other mortgage products, it should be up to the lender to judge affordability and suitability for the individual client. The lender must be able to explain and evidence the rationale for such lending and therefore we do not believe that the FSA should be prescriptive in defining a repayment method.

Q24: Do you agree that lenders should be free to set their own appropriate controls around repayment strategies?

We agree that lenders should apply relevant controls to each type of repayment strategy they accept but we also agree that lenders should be allowed to set appropriate controls themselves.

Q25: What is your view of our proposals for lenders' interest-only policies?

The proposal for lenders to have an explicit interest-only lending policy which is signed off at Board level is a prudent one. This should help ensure that lenders appropriately control their interest-only lending and have a clear framework in place to assess interest-only applications. However, no such requirement is enough on its own if it is not robustly supervised and enforced. We would therefore expect supervisors to make sure such policies exist and take appropriate action if they do not or are not signed off at Board level.

Q26: What are your views on our approach to requiring lenders to assess the repayment strategy prior to entering into the mortgage?

We agree that requiring lenders to assess the repayment strategy prior to the mortgage being issued is appropriate. Lenders should not be issuing interest-only mortgages where the repayment strategy is clearly inadequate.

Q27: What is you view of our proposals for the ongoing management of interest-only loans? Do you foresee any practical issues?

We were concerned about the feasibility of the original proposal, for periodic re-assessments of the appropriateness of the repayment vehicle during the mortgage term. While it would be more practical to re-assess the repayment vehicle on one specific occasion, as is now being proposed, it is still not clear what options would be available to lenders or consumers when a repayment plan is judged to be inappropriate. The FSA's consultation offers no further solutions in this regard.

The Panel assumes that lenders will not be able to withdraw the mortgage or require consumers to increase their savings. Consumers may not be in a position to remortgage at affordable rates and the Panel is concerned that they would be vulnerable to pressure sales of repayment vehicles, which may not be suitable, in order to keep their mortgage.

Q28: Do you have any comments on the proposed changes to the glossary term, or the consequential changes?

We have no comments in either of these areas.

Q29: Do you have any comments on the draft interest-only rules set out in the draft Mortgage Market Review (Conduct of Business) Instrument 2012 at Appendix 1? Do you think the rules reflect the stated policy intention?

We have no further comments on the rules.

Q30: Do you have any comments on our proposed approach to intermediaries' role in assessing affordability?

We agree that the lender must be the party which decides whether to advance the loan and therefore is ultimately accountable for the assessment of affordability. In our response to CP10/28 we highlighted that it would be confusing if the FSA were to require intermediaries to consider the customer's eligibility for a particular product as part of a more general appropriateness check.

Q31: (i) Do you have any comments on our proposed approach which allows high net worth consumers and mortgage professionals to opt-out of receiving advice and purchase on an execution-only basis?

We have maintained since the original launch of the MMR that there are some consumers who are sufficiently knowledgeable to use intermediaries to provide information on products that are available and then make their own choices. As we outline in our preamble we continue to believe it is the case that such consumers should be able to take out a mortgage through the non-advised sales route if appropriate.

However, we do not believe that this option should be confined to high net worth consumers and mortgage professionals alone. There are many other groups, in our opinion, who will have 'spoken or interactive dialogue' with an intermediary, but will not necessarily require advice. Second or third-time mortgage customers, for example, may need to be able to ask basic questions relating to terms and conditions and to what is available in the marketplace, but do not necessarily want or need to rely on an adviser telling them what is and is not appropriate.

Our preference would be for the FSA to leave the three tier system (of advice, non-advice and execution-only) in place, but to strengthen the information provided to the consumer on both non-advised and advised sales. It may, in addition, be possible to strengthen the requirements for first time buyers so that firms evidence that these buyers have provided due diligence during the transactions process, rather than to subject them to mandatory advice.

Revising the proposals along these lines would negate the need to define groups of consumers such as high net worth individuals. The latter definition itself we believe is flawed given we feel it sets the threshold income level for qualification too high and would most probably capture relatively few consumers.

Instead we believe the requirements should be tightened up for particularly vulnerable groups. So advice should be required for right-to-buy and the credit impaired as well as for individuals taking out equity release or sale and rent back products. It is highly important that definitions are tightly and appropriately defined in order to avoid any unnecessary unintended consequences.

(ii) Do you have any comments on our proposed definition of a 'mortgage professional'? (A question about the definition of a high net worth consumer is at the end of paragraph 10.83 in Chapter 10.)

We do not have any specific comments on this definition, notwithstanding our views at Q31 (i) above which makes the case for a different approach.

(iii) Is there anything we can do to mitigate the risk of intermediaries using these exceptions to circumvent the rules?

We state at Q31 (i) how we do not believe that exceptions should be required since we disagree with the overall rule proposals.

More generally, we do not believe the risk of mis-selling is as great as the FSA contends. While the information-only sales process is certainly not perfect, when it comes to reasonably straightforward products such as mortgages the two tier process shows little evidence of mis-selling. The main risk of mis-selling instead comes from intermediaries failing to check affordability. Now that the onus for checking affordability is on lenders this should no longer cause a problem at the earlier stage for most people.

(iv) Are there any other consumer types you think should be able to purchase on an execution-only basis in an interactive sale?

We believe this option should be open to all but the most vulnerable groups.

Q32: Do you have any comments on our proposed approach which allows consumers to opt-out of advice when purchasing products online or by post and allows them to purchase on an execution-only basis?

Although pure internet mortgage sales may still be low it is not beyond the realms of possibility that with technological advances it could become easier to purchase a mortgage in this way. Therefore given the potential growth of this channel, in particular, we believe that there should be a uniform application of the rules which apply to all prospective channels of purchase.

As we indicate at Q31 (i) advised sales should only be a requirement for the most vulnerable consumer and product groups.

Q33: (i) We are proposing that consumers who are vulnerable (i.e. equity release, Home Purchase Plan, Sale and Rent Back or right-to-buy consumers and those who are consolidating debt) should always be advised and therefore will not be able to purchase their mortgage through a non-interactive process. Do you have any comments on this approach?

We agree that vulnerable consumer groups should be getting advice. Therefore, we believe that for debt consolidation, sale and rent back and equity release advice should be a requirement and the non-advised sales process, which we believe is still valid in the traditional mortgage market, should be abolished. These rules should be applied irrespective of channel of purchase. For Home Purchase Plans we believe

that the non-advised sales route should still be an option, as we contend for traditional mortgage products in our preamble and at Q31 (i).

(ii) What are your views on our proposal to allow high net worth consumers and mortgage professionals to opt out of receiving advice irrespective of whether they are considered to be vulnerable?

We outline in our response to Q31 (i) above our views on the proposed exemptions.

(iii) Are there any other consumer types you think should always receive advice?

None other than those we have previously outlined in our responses to the questions above.

Q34: Do you agree that, except in the case of Sale and Rent Back, we should allow consumers to reject advice and proceed on an execution-only basis?

Broadly it is unlikely many consumers will go through the whole advice process and then reject that advice. However, for equity release and Home Purchase Plan markets we believe that the option of a final opt-out is on balance appropriate. We agree that this would not be appropriate for the sale and rent back market.

Q35: (i) We are proposing that intermediaries monitor their execution-only business. Do you have any comments on our proposed approach to monitoring?

These proposals appear appropriate but they need to also be appropriately supervised and enforced if they are to be effective.

(ii) Are there any other steps we should take to ensure that consumers are protected when purchasing on a non-interactive basis, e.g. should we place any other limitations on the types of consumers who are able to purchase online?

We do not believe further restrictions are necessary.

Q36: Do you agree that we should be specific about the appropriate method of disclosing service fees that are not simple flat fees?

We agree that the consumer should be made fully aware of the basis for the intermediary's remuneration so where flat fees are not applicable this necessitates a clear and transparent disclosure of the charging mechanism. The FSA requirements in this regard therefore appear to be appropriate.

Q37: Do you have any comments about our revised approach to the requirements for the messages on product range and remuneration to be given 'clearly and prominently'?

The Panel has consistently made the point that consumers are often overloaded with written information when purchasing financial products. Therefore, the FSA's

proposal for intermediaries to focus on key messages in this manner is to be welcomed.

Q38: Do you consider that the combined IDD template remains useful with respect to mortgage service disclosure?

While we acknowledge that the IDD contains some important information which is helpful to the consumer we do not have any specific comments on the template.

Q39: Do you agree that we should not apply the 'independent' and 'restricted' labels to the mortgage market, but instead require intermediaries to explain to the consumer in clear and straightforward terms any limitations to their service?

In our response to CP10/28 we said that we thought limiting the descriptions of advice, to bring them in line with the RDR labels of 'independent' and 'restricted', would offer a clearer understanding of what services are being provided. However, we agree with the FSA that ultimately what we want to achieve in the mortgage market is that the consumer clearly understands from the outset whether the product range available to them through a particular intermediary is limited. That way a consumer can, if they want to, shop around to see what may be available elsewhere. The FSA now believes that the best way to achieve this is "simply to impose a requirement on intermediaries to explain to consumers in clear and straightforward terms whether the product choice available to the consumer through them is limited and if so in what way." This has the effect that where the intermediary services a limited range of providers they will be required to inform the consumer of the number or the names of those providers. In these instances where the intermediary is providing a limited list the FSA should prescribe a clear script for what should be said so that it is clear that this list does not represent the whole of the market.

Q40: Do you have any views about our updated proposals for product disclosure?

We do not disagree with the proposals in this regard. However, we still believe there is a case to be made for the re-introduction of suitability letters, which were a helpful and well received component of the earlier Mortgage Code Compliance Board's regime. The FSA has argued against the reintroduction of suitability letters, principally because of the volume of disclosure the consumer receives as part of the mortgage process. While we are of the same view with regards to the potential effectiveness of disclosure and the danger of mandating too much, we believe that a suitability letter would be a more effective tool than some of the other information requirements. Certainly a record as proposed would not be as valuable to a consumer as a summary letter of their needs and circumstances with an accompanying explanation of why a particular recommendation had been made.

Q41: Do you have any comments on the draft rules on distribution and disclosure as set out in the draft Mortgage Market Review (Conduct of Business) Instrument 2012 at Appendix 1?

We have no particular comment on these rules.

Q42: Do you have any comments on the proposed policy approach on the calculation of payment shortfall charges?

We believe the FSA is correct to be more prescriptive about the types of costs which can be recovered in firms' calculation of payment shortfall charges. Firms must be fair and proportionate in their arrears calculations as this is an area with significant risk of detriment and hardship for consumers, especially in the current economic climate. Strong and decisive action by the FSA on this front is required to remind firms of their duty to treat customers fairly and signal the FSA's commitment to identify and take action against firms who are non-compliant.

We believe there is scope here to further strengthen MCOB 12.4.1 R in relation to making it clearer that not only should the charge be a 'reasonable calculation' of the cost of the extra administration, but to ensure that firms cannot create extra administration for the sake of charging. For example, some lenders have imposed several charges on a monthly basis: 'Unpaid Direct Debit Fee', 'Arrears Management Fee', 'Late Payment Management Fee', and 'Litigation Management Fee'. It is not always apparent that the extra administration serves any practical purpose to the lender or the consumer, yet there will be a 'reasonable calculation' of the actual cost of that extra administration. We would like to see the Rule make it clear that charges must also be 'proportionate and necessary' to prevent 'churning'. We believe such protection should be extended to all consumer mortgages in principle.

Q43: Do you have any comments on the proposed policy approach on direct debit payments?

We support the FSA's proposals in this regard. Borrowers should not be penalised with unfair charges that perpetuate the cycle of debt.

Q44: Do you have any comments on the proposal to extend the application of MCOB 12.4 and 13.3 rules to include payment shortfalls?

We support the FSA's proposals in this regard. All mortgage customers experiencing financial difficulty, however temporary, should be treated constructively, positively and sympathetically, with solutions to managing arrears being developed on an individual basis. Borrowers who have a reasonable chance of regularising their repayments should not be hindered from doing so by their lender.

Q45: Do you have any comments on the proposal to replace MCOB 12.4.1 R (2) with a rule permitting firms to remove concessionary rates where there is a material breach of contract unrelated to payment shortfall?

This new proposal, to replace the existing rule on concessionary interest rates and therefore preventing firms from removing a concessionary rate when a borrower falls behind with their mortgage payments, appears to be appropriate.

Q46: Do you have any comments on the draft rules on arrears management as set out in the draft Mortgage Market Review (Conduct of Business) Instrument 2012 at Appendix 1?

We have no particular comment on these rules.

Q47: Do you agree that the new prudential requirements are unsuited to meeting the objectives of the MMR, specifically deterring high-risk lending?

Part II of the consultation paper, and particularly Chapter 8, makes a good case why Basel III is not on its own an effective mechanism to address the high-risk lending that the conduct proposals in the MMR are trying to target. However, it does not reference the other potential reforms open to the Financial Policy Committee (FPC) and how these conduct proposals interact. We have previously raised our concerns that the FPC may not take adequate account of the consumer interest when making important decisions about the mortgage market. Instruments, such as loan-to-value caps, may be effective in stabilising the financial system but may additionally have serious adverse consequences for some consumers, limiting their options.

In our Six point plan,[31] we said we believed "that the FSA should pro-actively engage with the interim FPC to subject each macro-prudential instrument to a rigorous cost benefit analysis which takes account of the goals of financial stability and consumers' welfare. This preparatory exercise would facilitate the selection of preferred macro-prudential tools that would contribute most to financial stability while inflicting least direct damage on consumers, judged in terms of the impact on the availability and cost of financial services, including mortgages. Except in circumstances of immediate crisis, we would also expect the FPC, once fully operational, to consider in consultation with the Financial Conduct Authority, the consumer welfare implications of macro-prudential interventions."

We still believe this is vitally important ahead of the implementation of any of the FSA's conduct proposals but have yet to be assured that these discussions have taken place in sufficient detail.

Q48: Do you have any comments on the proposed risk-based capital requirement?

We have nothing to add on this point.

Q49: Do you have any comments on the proposed restriction in the eligible capital calculation?

We have nothing to add on this point.

Q50: Do you have any comments on this proposed liquidity regime?

We have nothing to add on this point.

Q51: Do you have any comments on the proposed scope and application of the regime?

We have nothing to add on this point.

31 ibid footnote 1

Q52: Do you have any comments on the draft rules set out in the draft Prudential Sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (Non-Bank Lenders) Instrument 2012 at Appendix 1? Do you think the rules reflect the stated policy intention?

We have nothing to add on this point.

Q53: Do you have any comments on our views, summarised in the table at the end of this chapter, about the MMR proposals which are either not applicable or where a straight read across to the equity release market is appropriate?

We agree with the proposals in this regard. In particular, we are pleased to see the requirement that all sales are now made on an advised basis, something we have pressed for consistently. We also believe it is appropriate that where consumers reject that advice they must know the terms of the product they want, with no need for further discussion or information from the intermediary, before they can continue.

Q54: What are your views on our proposal to treat the equity release market as a single market for regulatory purposes?

We believe this is a wholly sensible approach to take given that many consumers will be looking across both markets.

Q55: Do you have any comments on the tailoring we propose in relation to execution-only sales following rejected advice and scope of service?

We make the point at Q53 above that we support this proposal, with the additional protection suggested over and above what is required in the traditional mortgage market.

Q56: Is any other tailoring required for the equity release market? If yes, please explain.

We do not believe there is a requirement for any additional tailoring.

Q57: Overall, do you have any other comments on our proposed read-across of the MMR to the equity release market?

We have no further comments on the proposed read-across. However, we do believe that the FSA should be mindful of the potential for mis-selling in this market. Where endowments mature and there is a shortfall there is certainly potential for firms to sell their customers equity release products, so that they can remain in the property but which may mean borrowing more than their shortfall. The peak of sales of endowment mortgages was between 1986 and 1988 – so 25 year term mortgages are coming to maturity now.

Q58: Do you have any comments on our views, summarised in the table at the end of this chapter, about those mainstream MMR proposals which are either not applicable or where a straight read-across to the Home Purchase Plan market is appropriate?

Given that they serve the same purpose as traditional mortgages and therefore involve similar risks for consumers, we do not contend that there is a specific need to tailor the FSA proposals for the Home Purchase Plan market.

Q59 Do you have any comments on the tailoring we propose in relation to execution-only Home Purchase Plan sales following rejected advice and enhancing sales standards?

We have no specific comments other than to say that the requirement for the provider to say why a conventional mortgage would not be more appropriate seems sensible.

Q60: Is any other tailoring required for the Home Purchase Plan market? If yes, please explain.

We are not aware of the need for any specific tailoring.

Q61: Overall, do you have any other comments on our proposed read-across of the MMR to the Home Purchase Plan market?

We do believe that, given that these products are usually bought because of their compliance with Islamic law, it is important for the FSA to engage with the Muslim community to ensure that what it is proposing has no unintended consequences which may be unpalatable for Muslim consumers.

Q62: Do you have any comments on our views, summarised in the table at the end of this chapter, about those mainstream MMR proposals which are either not applicable or where a straight read-across to the Sale and Rent Back market is appropriate?

We believe that sale and rent back is an area where there are strong risks of significant consumer detriment and consumers require effective protection from the regulator. In particular we are concerned that some consumers may be vulnerable to pressure to engage in such a contract when this may not be in their best interest. The proposals therefore seem appropriate.

Q63: Do you have any comments on the tailoring we propose in relation to not allowing Sale and Rent Back consumers to reject advice?

We have made the point before that we believe this regime requires a robust approach to guarantee that sales are appropriate and affordable. In particular, the affect a contract has on the recipient’s access to means-tested benefits will have a significant impact on establishing whether the product is appropriate to the needs of that customer. By mandating advice and not allowing any opt-out on that advice the FSA should hopefully improve consumer protection in this regard.

Q64: Is any other tailoring required for the Sale and Rent Back market? If yes, please explain.

In our response to CP09/22 when the FSA initially took over the regulation of this market we contended that a 14 day cooling off period is too short post the completion of the sale. This is a significant decision for consumers and it is not equivalent to an agreement under the consumer credit act. We made the point then that we would like to see the cooling off period extended to 28 days and we still believe this would be appropriate.

We also feel there is a point to be made about the supervisory approach to firms operating in this market. At present supervision is in line with the general approach to other smaller firms. However, we believe that the potential for consumer detriment is such that the FSA should undertake more frequent visits to sale and rent back firms.

Q65: Overall, do you have any other comments on our proposed read-across of the MMR to the Sale and Rent Back market?

We have no further comments to make.

Q66: Do you have any comments on our proposal to define a bridging loan as a regulated mortgage contract with a term of 12 months or less?

This would appear a suitable definition.

Q67: Do you have any comments on how the affordability proposals should be applied to consumers taking out bridging finance?

Given most of these loans never actually lead to monthly repayments it makes sense that the lender, in those instances, would not be required to make an affordability assessment.

Q68: Do you have any comments on our proposed read-across of our interest-only proposals to bridging finance?

It is evidently of the utmost importance for borrowers to have a valid repayment strategy in place, especially given the speed at which equity may erode in bridging finance. Therefore the interest-only proposals appear reasonable.

Q69: Do you have any comments on our proposal that lenders consider the repayment or exit strategy of the borrower, and have a clear lending policy that reflects this?

We believe it is reasonable to expect firms not to accept speculative methods for the repayment of bridging loans so support these proposals. However, as with the other responsible lending policies that firms will now be required to keep, supervisors must regularly check that these are appropriate and take necessary action if not or firms are not adhering to them.

Q70: Do you have any comments on our proposals about extending bridging finance loans?

We support these proposals.

Q71: Are there any other factors that firms should consider in order to determine that a bridging loan is appropriate?

We are not aware of any additional factors.

Q72: Do you have any comments on our proposal which requires that intermediaries who only offer bridging loans should describe the restriction on their service to the consumer?

We agree with this proposal.

Q73: Do you have any comments on the proposed prudential regime for bridging lenders?

We have no specific comments on the prudential regime.

Q74: Do you agree with our views, summarised in the table at the end of this chapter, about the MMR proposals which are either not applicable or where a straight read-across to the bridging finance market is appropriate?

We agree with these views.

Q75: In addition to the proposed tailoring set out above, is any other tailoring required for the bridging finance market? If yes, please explain.

We are not aware of the need for any further tailoring.

Q76: Overall, do you have any other comments on our proposed read-across of the MMR to the bridging finance market?

No.

Q77: What are your views on our approach to high net worth consumers? Should we adopt a more freemarket approach, recognising that for some consumers, regulation is not needed to protect them from the decisions they make?

We agree that there may be some consumers who are quite willing and able to risk impairment, and these include High Net Worth individuals. As the FSA says at paragraph 10.76 “the more wealth a consumer has, the more willing they may be to take a risk”. Borrowing sums to fund, for example, a business venture would be potentially less risky for a wealthier individual. In the event that such a venture does not work out, and as a result they lose their home, the consequence for such a consumer is more likely to mean moving to a smaller home rather than losing the ability to afford any property at all.

However, we would not consider wealth to be the only factor which might determine whether someone were willing and able to take a greater risk. In the investments market professional clients are considered to possess the experience, knowledge and expertise to make their own investment decisions and assess the risks inherent in their decisions.

Q78: Would an elective approach similar to that adopted in the investment market be appropriate?

On the condition that the FSA monitors the perimeter of the regulated market carefully to guard against regulatory arbitrage we believe that the elective approach is appropriate.

Q79: Would it be appropriate for all mortgage rules to be forgone?

We believe it would be appropriate if the consumer fully understood the implications.

Q80: Would it be appropriate for all regulatory protections for high net worth to be forgone or should some, such as redress, for example, be retained?

We would be content for protections to be foregone on the basis that the consumer fully understood the implications. The FSA would need to be clear about what notifications a firm would be required to provide to an elective consumer of course.

Q81: What are your views on defining high net worth consumers – what do you consider the appropriate figures for income and assets?

We do not have enough expertise to be able to define the parameters of such a group. However, we do feel that the threshold for income in particular is set at a relatively high level and would be unlikely to capture anyone other than only a handful of consumers.

Q82: Do you agree that it is appropriate to extend the definition to include high net worth consumers acting as guarantors?

Subject to the changes we suggest at Q77 we do believe this is an appropriate extension.

Q83: Do you have any comments on how the affordability proposals should be applied to high net worth consumers?

In those instances where mortgage loans provided to high net worth borrowers do not require them to make monthly interest payments, for example a secured overdraft or a mortgage where the interest is rolled-up, it is not the consumer's ability to repay out of income that is the important factor in the lending decision. Instead as the FSA indicates at paragraph 10.84 it is the credibility of the consumer's ability to repay the loan at the end of the term. In these cases we therefore agree that the lender should not need to make an assessment of the applicant's ability to afford regular monthly mortgage payments. We also agree, though, that in those instances where the customer is required to meet monthly payments the affordability rules should apply.

Q84: Do you have any comments on our proposal to extend the tailored disclosure rules to high net worth consumers?

We agree that this is appropriate.

Q85: Do you think that to achieve this, an elective approach similar to that adopted in the investment market would be appropriate?

We agree that an elective approach is appropriate in this area.

Q86: Do you agree with our views summarised in the table at the end of this chapter about the MMR proposals which are either not applicable or where a straight read-across to high net worth lending is appropriate?

Subject to our comments on the questions above we agree.

Q87: In addition to the proposed tailoring set out above, is any other tailoring required for high net worth lending? If yes, please explain.

None aside from our earlier comments.

Q88: Overall, do you have any other comments on our proposed read-across of the MMR to high net worth lending?

We have no further comments.

Q89: What are your views on our approach to business lending? Should we adopt a similar approach to that proposed for high net worth consumers, recognising that for some consumers, regulation is not needed to protect them from the decisions they make?

We do not have a great deal of expertise in this area but it is one of considerable concern. We urge the FSA proactively to seek the opinion of representatives of small and medium sized businesses. Subject to that, we can see the advantage of an elective approach; it is unlikely that there is a simple correlation, which could guide regulatory policy, between the size of a business and its capacity to understand risks. If the elective approach were adopted, the FSA would need to monitor the perimeter of the regulated market carefully to guard against regulatory arbitrage and mandate a sales process under which business borrowers were informed by the intermediary of their right to forgo MMR protections.

Q90: How would we draw a line between those business borrowers able to take the risk and those who are not?

See response to Q89.

Q91: How would we prevent this proposal from being exploited as a means of circumventing our affordability proposals?

It is unlikely, as we say in our response to Q89, that there is a simple correlation, which could guide regulatory policy, between the size of a business and its capacity

to understand risks. Therefore we would suggest that firms should be required to draft a responsible lending policy for business lending which is both prudent and proportionate. It would then be beholden on supervisors to ensure that firms are acting according to that policy in their approach to business lending and not encouraging businesses to game the system.

Q92: Would it be appropriate for all mortgage rules to be forgone or should some, for example the arrears rules, be retained?

The arrears rules should be retained for business lending, including our suggested rule on charging, given it is equally possible for a firm to act unreasonably with regards to business borrowers on issues of forbearance as it is to a consumer.

Q93: Do you have any comments on how the affordability proposals should be applied to business borrowers?

We note that a business repayment mortgage and a business interest-only mortgage that does not have a credible capital repayment strategy would be subject to a test of affordability in terms of capital and interest payable whereas no such test would apply to a capital-only business loan secured against property. Such asymmetry of treatment may give artificial encouragement to capital-only borrowing and lending even when a repayment or an interest-only loan might be more in the businesses' true interest.

Q94: Do you have any comments on the proposed approach to professional standards in business lending?

We have no comments on this point.

Q95: Do you agree with our views summarised in the table at the end of this chapter about the MMR proposals which are either not applicable or where a straight read-across to business lending is appropriate?

Subject to our comments on the questions above we have no further comments.

Q96: In addition to the proposed tailoring set out above, is any other tailoring required for business lending? If yes, please explain.

None aside from our earlier comments.

Q97: Overall, do you have any other comments on our proposed read-across of the MMR to business lending?

We have no further comments.

Q98: Do you have any comments on the draft rules specific to niche mortgage markets in the draft Mortgage Market Review (Conduct of Business) Instrument 2012 at Appendix 1? Do you think the rules reflect the stated policy intention?

We have no further comments.

Q99: Do you have any comments on our estimates for the impacts of the affordability assessment? Do you have any data and/or analyses that could be informative about these impacts?

As we indicate in our preamble we have some general concerns with the FSA's evidence base for the impacts of the affordability assessment. The lack of data on borrowers' expenditure and of a clear definition of "hard-to-reduce living costs" has meant the FSA uses only approximate methods that incorporate, as is freely acknowledged, rather subjective assumptions.

As it is simply not known how closely these methods approximate the true impact of the MMR proposals we welcome the FSA's call for more quantitative evidence on impacts, against which policy would be reassessed.

Q100: Do you have any comments on our estimates for the impacts of the interest rate stress test? Do you have any data and/or analyses that could be informative about these impacts?

See response to Q99; we have no further comments in this regard.

Q101: Do you have any comments on our estimates for the impacts of the interest-only proposals? Do you have any data and/or analyses that could be informative about these impacts?

See response to Q99; we have no further comments in this regard.

Q102: Do you have any comments on our estimates of the combined impacts of the responsible lending requirements? Do you have any data and/or analyses that could be informative about these impacts?

See response to Q99; we have no further comments in this regard.

Q103: Do you have any comments on our estimates for the lending impacts of the responsible lending requirements? Do you have any data and/or analyses that could be informative towards estimating these impacts?

See response to Q99; we have no further comments in this regard.

Q104: Do you have any views on whether this balance between winners and losers is acceptable, given the importance of the protection obtained by the winners?

The question should be whether the FSA's well-being analysis provides sufficiently robust estimates to inform such a judgement. The burden of the Peer Reviews written by the two specialists commissioned by the Panel is that the FSA's well-being analysis cannot be confidently relied upon to guide policy thinking. We strongly recommend that the FSA respond to the criticisms contained in the Peer Reviews before coming to its final policy conclusions.

Q105: Do you have any comments on the age-related issues discussed above?
We do not have any comments.

Q106: Are there any other age-related impacts from our proposals not highlighted above? If yes, please provide details.

We are not aware of any particular impacts.

Q107: Do you have any comments on the disability-related issues discussed above?

We do not have any comments.

Q108: Are there any other disability-related impacts from our proposals not highlighted above? If yes, please provide details.

We are not aware of any particular impacts.

Q109: Do you have any comments on the gender-related issue discussed above?

We do not have any comments.

Q110: Are there any other gender-related impacts from our proposals not highlighted above? If yes, please provide details.

We are not aware of any particular impacts.

Q111: Do you have any comments on the pregnancy and maternity-related issue discussed above?

We do not have any comments.

Q112: Are there any other pregnancy and maternity-related impacts from our proposals not highlighted above? If yes, please provide details

We are not aware of any particular impacts.

Q113: Are there any race-related impacts from our proposals that we should consider? If yes, please provide details.

We are not aware of any particular impacts.

Q114: Do you have any comments on the religion-related issues discussed above?

We do not have any comments.

Q115: Are there any other religion-related impacts from our proposals not highlighted above? If yes, please provide details.

We are not aware of any particular impacts.

Q116: Are there any sexual orientation-related impacts from our proposals that we should consider? If yes, please provide details.

We are not aware of any particular impacts.

Q117: Are there any transgender-related impacts from our proposals that we should consider? If yes, please provide details.

We are not aware of any particular impacts.

Q118: Do you have access to, or know of, any statistics regarding the mortgage needs and habits of groups with protected characteristics that could help us with our analysis? If yes, please provide details.

We do not have any specific evidence which relates to any particular group which could help with the FSA analysis. However, we would expect the FSA to ensure that all potential implications have been addressed, particularly where aspects of equality and diversity are involved.