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

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

Ms Lynda Blackwell

Financial Services Authority

25 The North Colonnade

Canary Wharf

London

E14 5HS

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Dear Ms Blackwell

Mortgage Market Review: Responsible Lending

This is the Financial Services Consumer Panel's response to questions 16 to 22 of the FSA's consultation paper into responsible lending in the mortgage market (FSA CP 10/16 ***). The Panel would also like to take this opportunity to make some high level comments on the general case for intrusive affordability assessments and the overlap between these and the new regulatory arrangements.

The Panel supports the FSA's aim to promote a more effective approach to protecting mortgage customers, given the widespread examples of irresponsible lending identified in the MMR and welcomes the FSA's commitment to responsible lending within the mortgage market. We have previously endorsed the need for the flexibly applied verification of income and for reform of firms' unacceptable arrears handling practices.

However, this review is being carried out during an extended public debate about the future shape of regulation of the financial services industry. The outcome of the debate is likely to have a significant impact on the regulation of the mortgage market going forward and therefore on the future character of the market. We are concerned that the present proposals should take into account the likely future role of the Bank of England and the macro-prudential policies the Financial Policy Committee may adopt to deal with an emerging property bubble. We have been assured by the FSA that such considerations are being taken and that a thorough impact analysis of the proposed affordability rules for the supply of mortgage credit has now been completed. We look forward to seeing the results of that analysis shortly

We have serious concerns about the potential unintended consequences that may result from the MMR proposals. In the absence of a clear central housing strategy, the Panel would like to be reassured that the Government is well aware of the full and wider implications of the Review and that it is, indeed, considering what action it may need to take in light of a changing home-ownership population.

The Panel is mindful that a balance must be found between the regulation of the prudential and conduct of business sides of the mortgage sector; the two must be closely aligned so they work effectively together and do not greatly increase costs or damage the market. The Panel is concerned about the costs of overlapping regulations.

Now that the future regulatory structure is clearer, it is important that the FSA considers whether 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. The FSA should continue high-level discussion with Treasury and the Bank of England to develop a coherent approach to the mortgage market. The resolution of the potentially costly and socially damaging overlap between counter-cyclical macro-prudential regulation and the MMR proposals is so important to consumers that we stress that we make this response to the consultation conditional on an overall regulatory solution being agreed between the FSA and the Bank that we find satisfactory.

You will be aware that the Panel has been pressing the FSA to ensure transitional arrangements adequately provide for consumers who have historic mortgages that may now lie outside the developing 'responsible lending' criteria. We appreciate that the FSA team is already considering these issues and we are keen to maintain an effective dialogue as the MMR continues. Appropriate and effective transitional arrangements are so important to consumers that the comments we make in the remainder of this response are conditional on us being able to subsequently approve the transitional arrangements and on our acceptance of the results of the FSA's current research into the human and social consequences of its proposals

We are finding it impossible to provide fully detailed responses to some of the questions on the latest set of proposals, such as those regarding interest only mortgages, given that we do not yet know of the FSA plans for transitional arrangements. Taking the caveats outlined above into account, the Panel has responded to questions 16 to 22 in the consultation paper. Within its response to the questions on interest-only mortgages, the Panel sets out its concerns that some of the proposals may be too prescriptive with the risk of detrimentally removing a customer's ability to use interest-only mortgages. The proposals could stop some consumers who would use this product appropriately from accessing it and could also inhibit the market. This would be detrimental for current and future mortgage customers. The Panel would recommend that the FSA works with organisations such as Shelter and Citizens Advice, along with the relevant trade associations, to identity areas where it is likely customers would not be best served with an interest-only mortgage.

The Panel would like to see a regulatory environment emerging from the Review 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 supports the regulator in taking a more effective approach to supervising the granting of these mortgages, through requiring firms to explain the affordability assessments that were made and why an interest-only mortgage was deemed appropriate. The Panel believes this would be a proportionate approach to mitigating consumer detriment through requiring firms to make sound judgements on their appropriateness.

We welcome the opportunity to discuss this proposal in further detail in the coming months.

Yours sincerely

Adam Phillips
Chair, Financial Services Consumer Panel

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Financial Services Consumer Panel's response to FSA CP 10/16***:

Mortgage Market Review: Responsible Lending - Interest-only Mortgages

Question 16: How prescriptive should we be in defining a valid repayment method?

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.

However, the Panel believes that interest-only mortgages are a legitimate financial product for some customers, who may have a range of reasons for choosing it. 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 with supporting evidence the rationale for such lending within the risk assessment process. Therefore we do not believe that the FSA should be prescriptive in defining a repayment method

Question 17: Should the lender be required to check that there is a valid repayment method in place at the start of the mortgage, and then periodically through the term of the mortgage? How do you think this should work? How often should lenders check on the repayment method?

The Consumer Panel believes that an initial assessment at the time of sale may be appropriate but it is concerned about the feasibility of periodic re-assessments of the appropriateness of the repayment vehicle during the mortgage term. It is not clear what options would be available to lenders or consumers when a repayment plan is judged to be inappropriate. 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. The Panel will require further information on how periodic reassessments would be implemented before it can properly consider this proposal.

Question 18: Do you think there should be further controls on repayment methods? For example how should the 'sale of property' be controlled to prevent it being used where it is not a realistic option? If a minimum LTV, amount of equity or income level was set, where and how should this be done?

The Panel thinks that the ‘sale of property’ is a legitimate and valuable way for some consumers to arrange their mortgage. We recognise, however, that expectations of continued house price inflation have resulted in unrealistic assumptions among both lenders and consumers regarding the potential for property sale to repay capital. The Panel notes that the majority of people with interest-only mortgages expect to repay through the sale of the property. It is essential that the lender assures themselves that the borrower fully understands the implications of down-sizing in the future in order to repay their loan. We suggest that CFEB could play a valuable educational role here.

Question 19: Do you agree that these customer types benefit from interest-only mortgages? Are there any other customer types that might benefit from interest-only?

As the Panel noted in its covering letter, the Panel believes that interest-only mortgages are appropriate in some circumstances. Instead of trying to identify specific consumer groups for whom interest-only mortgages are appropriate, the Panel believes the FSA should, instead, set out the circumstances in which this product would not be deemed acceptable, for example, is there a case for closer supervision and support in the form of advice at point of sale for high-risk borrowers and specifically the credit impaired? This would allow lenders flexibility, within clearly defined boundaries, and allow the market to innovate to the benefit of consumers. This needs to be supported by a more effective approach to supervision, requiring lenders to explain the affordability assessments that were made and the reasons why an interest-only mortgage was deemed appropriate.

Question 20: Do you agree that some form of interest-only product without need for a repayment vehicle may be appropriate on a temporary basis for first-time buyers? If so, how should this be achieved? Would there be any specific impact on older consumers.

The Panel agrees that there may be occasions where there is no need for an explicit repayment vehicle; again the Panel believes the lender should assess the individual customer’s circumstances and make that decision at the time of sale. It is essential that the lender assures themselves that the borrower fully understands the implications of down-sizing in the future in order to repay their loan. This applies to both existing home owners and first time buyers

Question 21: Do you agree that there are some limited circumstances where assessing affordability on an interest-only basis may be appropriate? If so, when? And should any additional controls be applied to prevent this being gamed.

As the Panel outlined in its covering letter, it believes that there are some circumstances in which affordability should be assessed on an interest-only basis. We also believe, however, that lenders must be required to proactively assess the appropriateness of this course of action and to explain their decisions as part of a more effective supervisory approach.

Question 22: Do you think that any changes to our interest-only requirements will impact any groups with protected characteristics (e.g. race or religion)

The Panel is not in a position to respond to this question in the short consultation time which has been allowed for responses to these questions.