

Shelter's response to the FSA discussion paper – Mortgage Market Review

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Shelter

Shelter is a national campaigning charity that provides practical advice, support and innovative services to over 170,000 homeless or badly housed people a year. This work gives us direct experience of the various problems caused by the shortage of affordable housing across all tenures. Our services include:

- A national network of over 20 advice centres
- Shelter's free advice helpline which runs from 8am-8pm
- Shelter's website which provides advice online
- The Government-funded National Homelessness Advice Service, which provides specialist housing advice, training, consultancy, referral and information to other voluntary agencies, such as Citizens Advice Bureaux and members of Advice UK, which are approached by people seeking housing advice
- A number of specialist services promoting innovative solutions to particular homelessness and housing problems. These include Housing Support Services which work with formerly homeless families, and the Shelter Inclusion Project, which works with families, couples and single people who are alleged to have been involved in anti-social behaviour. The aim of these services is to sustain tenancies and ensure people live successfully in the community.
- We also campaign for new laws and policies - as well as more investment - to improve the lives of homeless and badly housed people, now and in the future.
- Our services have seen a large increase in queries from clients in mortgage arrears over the last two years.

Summary

Shelter welcomes this discussion paper, and the thorough and fundamental approach the FSA has taken. Based on the evidence presented in the paper and our own research and housing advice casework, we recommend:

- The adoption of tighter lending criteria, including income verification in every case and affordability checks that assess outgoings as well as income
- Reform to FSA regulations on arrears management, to make guidance into binding rules
- Extension of the FSA's scope to include the regulation of second charge and buy-to-let mortgages

Introduction

The need for reform

The high risk strategies and irresponsible lending practices of some lenders in recent years did not just have a negative effect on the wider economy. Every day, Shelter advises clients who are going through the trauma of mortgage arrears and repossession:

- There is high demand for mortgage possession advice across all face to face and Helpline services. We also give advice to anyone facing mortgage repossession at court as part of the Housing Possession Court Duty scheme
- Our dedicated homeowner helpline staff take around 300 calls relating to arrears and repossession every month
- Our advice webpage on repossession had over 33,000 page views between July-September 2009
- We have actively lobbied for greater regulatory intervention in the mortgage market since the beginning of the economic downturn and undertaken primary research to monitor trends in arrears and repossessions

Whilst the government has responded quickly to the repossessions crisis, there remain a number of unresolved long term issues that need to be addressed to ensure that such a crisis does not happen again. We are pleased to see that the FSA is taking a fundamental and long term view. Although the market has changed a great deal through the recession and many lenders are already exhibiting more responsible behaviours and lending more prudently, it is vital that these

measures are enshrined in regulation to prevent more reckless lenders from returning to some of their former practices when the market has recovered. The concentration of irresponsible lending in the non-prime sector and its disproportionately high levels of arrears and repossessions suggest that regulation needs to be targeted at these higher risk lenders.

Some of the proposals are substantial and require further detailed discussion, but we believe there is a pressing need to push ahead with an ambitious timetable of reform, particularly on those areas that have wide ranging consensus.

The wider housing market

If the proposals in the discussion paper are adopted, borrowing – and therefore access to home ownership - will undoubtedly become harder for some people. Whilst we emphatically agree with this overall thrust of more responsible, long term lending, we are concerned about the remaining options for those households who will find they are unable to secure mortgage finance.

In particular:

- Access to social rented housing is extremely limited due to short supply
- There are no agreed proposals to improve access to intermediate tenures
- The private rented sector can be costly, property conditions can be poor, and it does not guarantee any security of tenure

We do not think that discussions about access to mortgages should be decoupled from reform to the wider housing market. Whilst regulation is an important lever, structural under-supply of housing means that regulation alone will not be enough to control sustained house price rises in the future. We recommend that the FSA takes this up in wider discussions with government departments.

Similarly, restrictions on mortgage lending must be considered in the context of the wider credit market. Recent evidence suggests that as many as one million households may be using credit cards to pay off mortgage or rent costs.¹ An unintended consequence of tighter mortgage regulation could be more households - especially existing homeowners who are unable to remortgage - turning to expensive unsecured credit to service their housing costs, and exacerbating their debts.

¹ Shelter press release, 11 January 2010:
http://england.shelter.org.uk/news/january_2010/1m_paying_for_homes_by_creditcard

Enforcement

We are concerned at the lack of new proposals in the review as to how the FSA might improve its approach to monitoring and enforcement. Whilst some of the reckless lending and poor arrears management of the past was due to weaknesses within the rules themselves, much poor practice could have been avoided if a more stringent and effective compliance regime was in place, targeted at the worst offenders and those with particularly risky business models. For enforcement to be effective, it must be sufficiently resourced. The FSA should also be more open about naming and shaming firms which have broken the rules, and publishing compliance data.

Comments on the review, section by section:

1. Overview

We agree with the FSA's broad aims to have "*a mortgage market that is sustainable for all participants*" and "*to have a flexible market that works better for consumers*". The review should contribute to a wider programme of reform to achieve long term housing market stability, where individuals have access to home ownership that is sustainable and affordable. A further aim should be to drive down, in real terms, levels of arrears and repossessions in the future. The FSA's aims should also reflect the balance that must be struck between a less risky market, but a market that does not unnecessarily exclude people or contribute to economic inequality.

2. Macroeconomic background

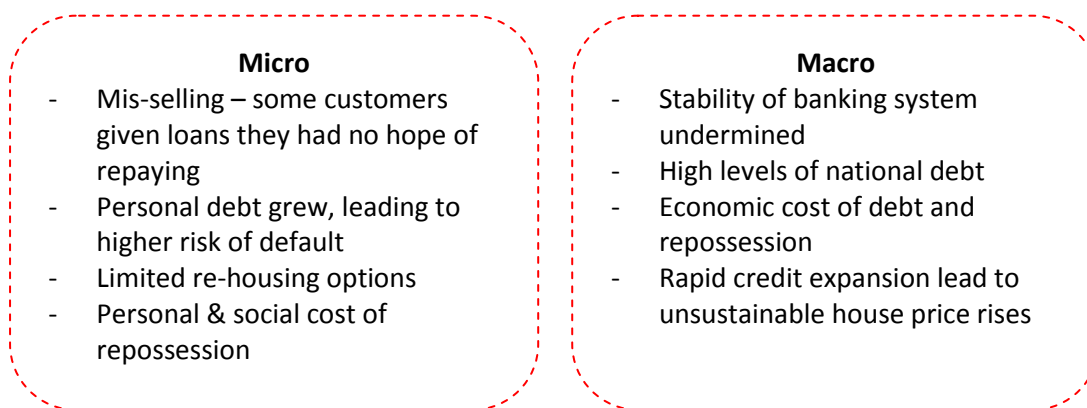
The analysis recognises the significant role unsustainable mortgage lending has played in the recession, whilst acknowledging that it is not the only cause of the downturn. There is wide recognition that the 'originate to sell' model and the extremely risky activities of some lenders were damaging to both consumers and the financial sector. Some households have undoubtedly benefitted from the expansion of credit. But it is not necessarily the case that widening access to home ownership has promoted social or economic equality:

"Whilst it [home ownership] has appeared to be a road to capital accumulation for a broad class of citizen, it has also been a primary mechanism by which households have accumulated debts and economic risks... In analyses over the last 25 years of occupation, household income, tenure and capital gains, it appears that those in managerial and professional occupations have made the

*largest gains...Moreover, not only has owner-occupation brought greater financial benefits to middle-class homeowners than to working class ones, capital gains made from owner occupancy have disproportionately advantaged those at the top end of the market.*²

The FSA rightly concludes that relatively cheap and easy credit was a major cause of artificial house price inflation and of a common belief that property was a sure way to realise financial gain. But we would also point out that continued Government policies to promote ownership as the only tenure of choice, a lack of available social housing and problems with security and standards in the private rented sector have also contributed to this phenomenon.

Our interest lies not just in wider housing market economics, but also in outcomes for individuals. The effects of irresponsible lending have been wide ranging:



Shelter advisers have seen a huge surge in enquiries from households in mortgage arrears over the last three years. Arrears are, in the majority of cases, due to unemployment or another unexpected change in life circumstances such as illness or relationship breakdown - factors which cannot be regulated out of existence. But frequently, lenders gave loans that were too large from the outset, and borrowers were unable to withstand any stress, such as a sudden rise in interest rates or a temporary income shock:

- A Shelter survey of sub-prime borrowers³ in May 2009 indicated that 36% of borrowers who expected a reduction in income would no longer be able to meet their mortgage payments.

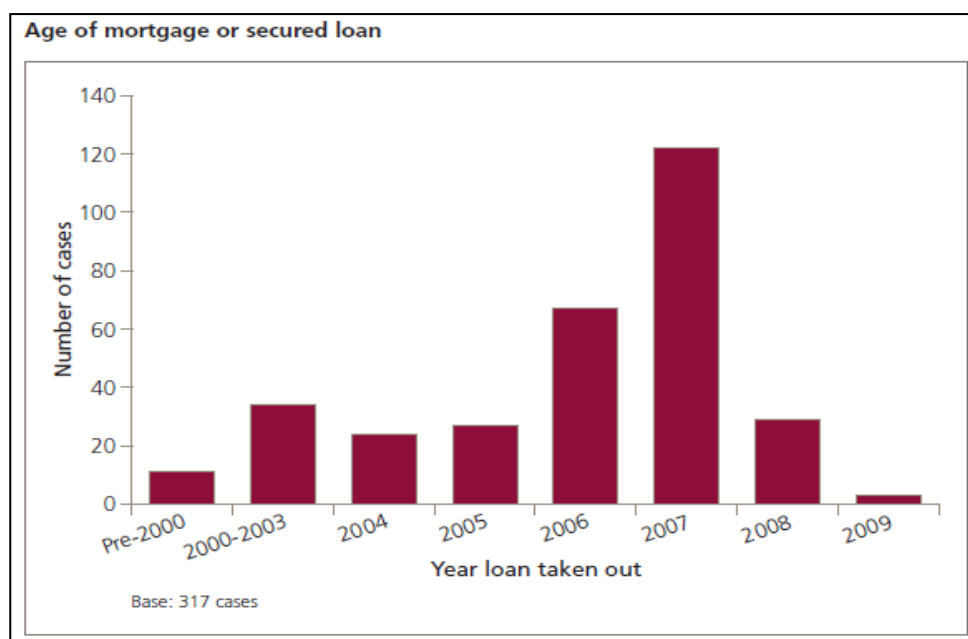
² Ronald, R. *The Ideology of Home ownership: Homeowner Societies and the Role of Housing* Palgrave Macmillan 2008

³ *Survey of Sub-prime borrowers: Results and Recommendations*, Shelter May 2009

Very few respondents who were coming off fixed rate mortgages had budgeted for an increase in payments.

- There is evidence that irresponsible lending is still taking place. One mystery shopping exercise found that first time buyers were able to find offers, including from high street banks, which would leave them with such low levels of monthly disposable income that it could push them over the poverty line.⁴
- Recent research into mortgage possession action in the county courts found that 61% of clients at court had taken their loans out after 2006, where recorded, indicating that these loans were perhaps not affordable from the start. The table below gives more detail. 10% of those at court cited 'over-commitment' as one of the reasons for their arrears, and borrowers facing repossession were overwhelmingly from low-income households, on the margins of affordability.⁵

Figure 1: Age of loans in a sample of repossession cases



Repossession can have devastating effects on families and individuals, leading to homelessness in the worst cases. For this reason, we are glad to see the FSA finally toughening up, and we welcome the review's commitment to stamping out reckless lending. The FSA's proposals will,

⁴ ROOF magazine, November/ December 2009 edition

⁵ *Turning the tide? Evidence from the free advice sector on mortgage and secured loan possession actions in England in July 2009*, AdviceUK, Citizens Advice, Shelter, December 2009

primarily, promote responsible lending. But action is needed to address other weaknesses in the mortgage system, outside of FSA's control. We would like to see similar momentum on:

- Review and reform of mortgage law, to close legal loopholes, give judges greater discretion in repossession cases, and give the pre-action protocol a stronger statutory footing
- Review, reform and possible additions to safety nets, including both Support for Mortgage Interest (SMI) and Mortgage Payment Protection Insurance (MPPI), so that there is comprehensive help available if things go wrong for borrowers

3. Prudential reform

Q1-4:

We agree with the proposed prudential reforms. It is essential that firms have adequate capital and sustainable funding models. However, we suggest that further analysis is needed on how these proposals could impact on the cost of borrowing for consumers. Whilst prudential reform is key to overall stability, it is only one part of the story. The way that lenders loan money, manage accounts and deal with their customers is what really makes a difference to consumers, so it is essential that Conduct of Business reform takes place alongside prudential reform.

We particularly welcome the additional prudential regulation for non-banks, who are shown to have as many as 30-60% of their mortgage books in arrears. It is appropriate for the FSA to direct further regulatory requirements towards these high risk institutions.

4. Conduct of Business reform

Q5: Do you agree with our analysis that, on the grounds of consumer protection, there is no case for prohibiting the sale of loans above certain LTV, LTI or DTI thresholds?

Loan to Value

Clearly, high LTV lending should not be seen in isolation as the single cause of economic turbulence. However, thresholds on LTV could potentially result in fewer defaults, by ensuring that customers have a 'cushion of equity' when they first enter into a loan arrangement. Limiting how much can be borrowed might also help to push house prices down – lower LTV means less

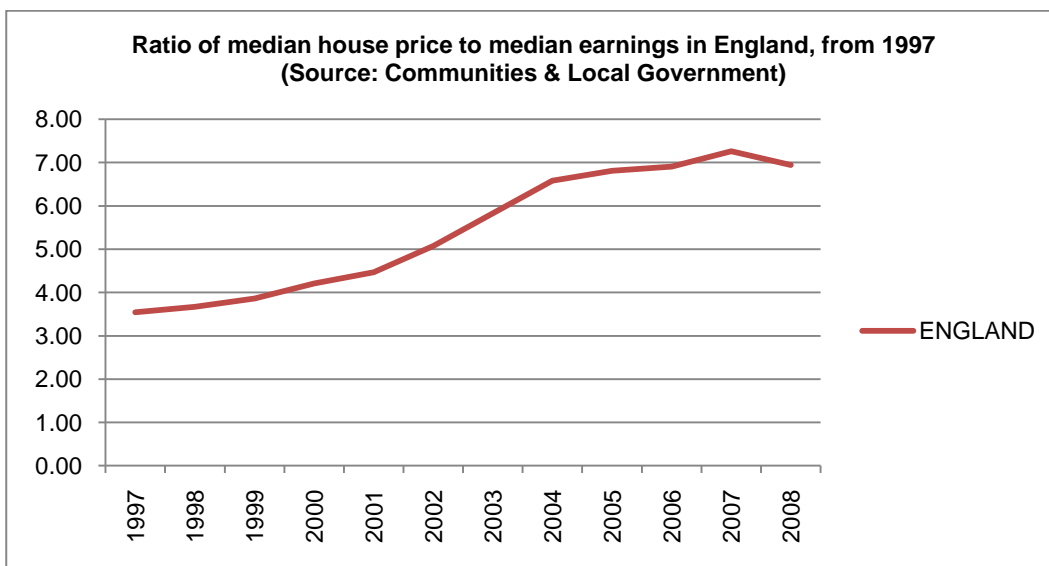
demand, lower offers and therefore should mean a less (artificially) inflated house price bubble over the long term.

But LTV is not always a reliable indicator of affordability, as house prices are so volatile. LTV may have been reasonable and affordable at the time of purchase, but significantly higher if house values have declined. Capping LTV would not, we feel, get to the root of the affordability problem, and could freeze out first time buyers who have stable income but are unable to save a large deposit in the short term.

Loan to Income

As with LTV, we believe that LTI ratios have increased significantly as house prices have risen, but average earnings have failed to keep up:

Figure 2: house price- earnings ratio



Whilst we believe that LTI is often a more reliable indicator of affordability than LTV, there are still significant variables – level of outgoings, unpredictability of job loss or pay decreases, inability to predict income rises, and fluctuating interest rates. Given these variables, we do not think that caps on LTI necessarily reduce the risk of arrears significantly. Nonetheless, lenders will have their own processes for determining LTI, and it seems reasonable that no lender would normally loan over 7 times LTI.

Debt to Income

We agree that DTI reflects more nuance than LTV or LTI. But it is not clear how, practically, a mortgage lender could assess a customer's entire future debt levels, when credit might be sought from a number of sources, potentially with different regulatory regimes and information sharing protocols.

Were the FSA to pursue this route, more research would be needed on the 'ideal' DTI ratio:

- Experts have suggested that households should spend around 30% of their income on housing costs.⁶
- In the U.S. the Homeowners Affordability and Stability Plan included measures to reduce borrowers' repayments to around 31% of income to avoid foreclosure.⁷
- French regulations require that (most) households cannot pay more than 33% of their income on mortgage costs.
- In reality, in 2008 around 2.2 million households (9%) in Britain paid more than half their income on housing costs.⁸

Overall, we conclude that whilst introducing thresholds (on LTV, LTI, or DTI) is a rational response to irresponsible lending, there are a number of issues that make this an unviable option:

Risks to the market	Risks to consumers
Thresholds are a blunt tool - more nuanced affordability assessments are needed to establish personal circumstances, outgoings and suitability of loan	Households may turn to expensive unsecured credit or unregulated lending to finance ownership
There may be circumstances where <i>responsible</i> high LTV /LTI lending is affordable and even appropriate – caps could close this part of the market	LTV thresholds in particular might create economic inequality - only those with large amount of capital for deposits can be owners. This could exclude first time buyers and existing mortgagors in negative equity

⁶ *Breaking point: How unaffordable housing is pushing us to the limit*, Shelter 2008

⁷ <http://www.treas.gov/press/releases/tg33.htm>

⁸ *Breaking point: How unaffordable housing is pushing us to the limit*, Shelter 2008

Therefore, whilst statutory restrictions on LTV, LTI or DTI might be a straightforward regulatory rule, putting all lenders on a level playing field, and giving consumers a clear cut idea of what to expect, there are a number of risks. We agree that introducing thresholds is not a sufficiently sophisticated tool to regulate risk in this complex market.

Q6: Do you consider that the FSA should prohibit the sale of mortgages to borrowers with multiple high-risk characteristics? If yes, what particular combinations of risk factors should the FSA consider prohibiting and why?

The rationale behind this idea is generally sound. However:

- This proposal may not be necessary if income verification and affordability tests are to be required for every loan.
- Some factors identified are historical – for example credit scores are largely retrospective and might not give a good indication of a household's current/ future financial situation.
- As the review rightly points out, there would be added difficulty for existing 'high-risk' homeowners who are seeking to remortgage. If they are unable to access new mortgage finance, households would probably have to sell and move to the private rented sector, where tenancies are insecure and rents for family sized homes can be as much as mortgage costs in any case. This could lead to households, in particular families, getting stuck in overcrowded accommodation. Transitional arrangements should be made for any new regulations which would adversely affect existing borrowers.

Q7: Do you consider that requiring verification of income by the lender for all mortgage applications is a viable option, and one which is sufficient to ensure responsible and sustainable levels of mortgage lending?

Case study 1 *Shelter advised one client facing mortgage repossession who had self-certified his income as nearly £700,000 a year. But in reality he was only earning a fraction of this. The client had been desperate to keep hold of his family business and home - a farm - and had unrealistically hoped to recoup the mortgage costs within a few years. After having an accident that made him unable to work, he was unable to keep up the payments and eventually lost the farm.*

We cannot see any situation where it would be in the interests of the borrower, or the lender, for income not to be verified in some way, and we fully support income verification for all new mortgage applications.

Self-certification

The self-certification (self-cert) market has proved to be unsustainable, with the last major self-cert lender pulling out of the market in November 2009.⁹

While the original aim of the self-cert market was to provide credit for self employed people, it is very clear that self-cert lending went way beyond this, with nearly half of loans having no income verification in 2007. Self-cert loans are also shown to be larger, with higher levels of arrears. Therefore we believe that targeting regulation here is proportionate and risk-based.

Nonetheless, it is absolutely essential that self-employed people or others with irregular income, or groups like the police who cannot supply employer references, are not unfairly excluded from the market. But we are not convinced that banning self-certification would do this – it should just require lenders to make better efforts to check income. This might be through:

- Tax returns – self-employed people are required by law to keep records of business and fill in a tax return every year
- Bank statements
- Company accounts or accountants' certificates
- Invoices or contracts

Checking income is standard in other countries, and indeed across other housing and finance areas in the UK – private renting, insurance etc. Online banking and other technological advances mean that accessing proof of income should be relatively straightforward and fast.

Some lenders have argued that self-cert products do fill an important niche in the market and might be retained – yet we have not been presented with any good examples of when and why this product is needed.

⁹ <http://www.guardian.co.uk/money/2009/nov/04/platform-ends-self-cert-loans>

Fast track

Since the release of the mortgage market review, a number of lenders have argued that fast-track, particularly to existing customers, is a less risky area of business than other non-income verified (NIV) products, and does not need further regulation.

But we agree with the FSA analysis that, as with self-cert, fast tracking has become too prominent and been used in circumstances where it was not necessary. Even if borrowers are long standing, low risk customers, it is still in the lender's interest to make a quick and simple check of plausibility and income, particularly in current economic circumstances. Furthermore, it would not make sense to ban self-cert but retain other NIV products, as it is possible lenders would then use these products in place of traditional self-cert.

Q8: Do you agree with our proposal to require lenders to take ultimate responsibility for affordability?

We agree that lenders are ultimately responsible and therefore must hold intermediaries to account. Nonetheless, intermediaries must not neglect their duties to assess (initial) suitability for a loan or try to push borrowers towards choosing mortgages that are not in their best interests.

Q9: Do you agree with our proposal to require lenders to assess affordability based on;

- (i) **the borrower's free disposable income;**

We agree that lenders should look at outgoings as well as income, and that this is a more sophisticated and effective means of determining ability to repay than income multiples alone. Whilst such affordability assessments could make borrowing harder for households with relatively high income but high outgoings, it could also benefit those who have low incomes but spend and save effectively to maximise their budgets. Further work is needed to establish exactly what information lenders should check, but spend associated with tax, utilities, property maintenance, childcare and travel are obvious examples of expenditure that should be taken into account. The Common Financial Statement method,¹⁰ used widely between debt advisers and creditors, is a

¹⁰ The CFS is usually completed by a debt adviser on behalf of a client to ensure accuracy. It assesses income, assets, expenditure and priority and non priority debt to create a financial statement indicating how much money is left available for creditors.

good example of a simple and effective way of determining how much money households have available. A common model, similar to this, might be developed for mortgage lenders to incorporate into their assessment systems. However, some lenders will already have sophisticated assessment models that go above and beyond FSA's expectations, so there should be some flexibility around what system lenders use. The assessment, and subsequent suitability letter, should also include stress testing to consider plausibility of the mortgage in the event of interest rate rises.

However, we would wish to stress that affordability assessments are a snapshot in time, and can never be an exact science. For example, a household might spend a lot on leisure activities, but plan to cut down on this spend once a mortgage has been secured. Equally, a household might have a comfortable level of disposable income, but a life event – like the arrival of a new baby – can quickly change this. Some households are well aware that they will be overstretching financially on a mortgage, but will have contingency coping mechanisms, such as taking in a lodger. Full affordability assessments may not be needed for existing customers who are re-mortgaging and have a good track record of payments, low LTV etc.

(ii) **a consumer's borrowing capacity;**

A requirement that firms cannot lend to anyone with low, zero, or negative borrowing capacity seems entirely sensible.

(iii) **the plausibility of the information obtained;**

Any move to stricter requirements on income verification should help to minimise mortgage fraud and give lenders more certainty that applications are plausible. We agree that lenders should try to verify expenditure through simple checks, such as comparing information with average expenditure statistics and credit ratings agency data.

(iv) **a capital repayment basis;**

Interest-only loans do hold a useful place in the market, for example for consumers switching to interest-only as a short term coping mechanism to manage with (temporary) financial difficulty. But borrowing without any repayment vehicle in place is

extremely risky, particularly if house prices are not rising. Therefore, the affordability assessment should ensure that borrowers taking out interest-only mortgages have sufficient disposable money after payments to contribute to a vehicle to cover the capital sum. We understand where no repayment vehicle is specified that most lenders test affordability on an equivalent capital repayment basis as a matter of good practice, and we agree that this should be a standard part of affordability tests. Borrowers should have access to the different assessments so that they can make an informed decision.

Q10: Is the increased focus on affordability the right way to ensure sustainability of lending and consumer protection?

Case Study 2: *In one Shelter case, a man in his late 60s was sold a mortgage of nearly £75,000 – much more than he needed to purchase his council property – through a broker. The man was illiterate and unable to check the content of the mortgage application, which clearly overstated his income and claimed that he was working when in fact he was retired. 'Hard sell' techniques were used when it was clear that the client, a vulnerable elderly man who suffers from memory loss and confusion, did not understand the commitment that he was making. He subsequently got into arrears and was facing possession action. Shelter helped the man onto the Government's Mortgage Rescue Scheme.*

Affordability – including assessing ability to repay through income and expenditure – is the right way to increase consumer protection. Households may be able to secure access to a mortgage but then live in constant fear of default, having to cut back on other essentials like food and heating.

Sustainable lending must also include:

- Transparent policies and practices so that all parties understand processes and risks
- Customer awareness of sources of independent, good quality financial advice prior to accessing credit
- Loans which are realistic, where customers will be able to repay and the whole life of the loan is considered. For example, we would like to see more careful consideration of lending into retirement
- Clear advertising standards
- Consistent application of rules across all lenders
- Assessment on a case by case basis, with records kept of all decisions made
- We also recommend that all loans are stress tested against potential interest rate rises

As we have already indicated, this tightening of mortgage criteria must be seen as part of a wider package of reform. Would-be homeowners who do not meet affordability standards will have to live somewhere – we urge wider government to consider this factor, and develop stronger policies to improve affordability of ownership, and improve the intermediate, social and private rented sectors.

Q11-12: No comments

5. Distribution & advice

Q13-16

We have no detailed comments on these proposals, or additional evidence of poor practice in the intermediary sector. However, we are aware of extremely poor practice in the intermediary sector, particularly affecting vulnerable borrowers, as demonstrated in the FSA's thematic research and through consumer research such as the Citizens Advice 'Set up to Fail' report.¹¹

We broadly agree with and welcome moves to:

- Strengthen intermediaries' sales standards
- Clarify the balance of responsibilities between intermediaries and lenders
- Encourage internal record keeping and encourage consumers to shop around by introducing suitability letters as standard. Suitability letters could contain illustrations of risk – for example by showing different repayment scenarios in the event of interest rate rises. This would allow borrowers some time to reflect on their decisions and consider how they want to weigh up risks.

Taking on a mortgage is a major financial commitment. Households, particularly those who are engaging with the mortgage market for the first time, do not have a source of free and impartial, tenure-neutral advice about their housing options. Few may understand the difference between advised and non-advised sales, and non-advised sales do not currently include full suitability assessments. Therefore we consider that all first time buyer sales should be advised. The FSA has also identified, through its thematic work, the bad practice and high costs displayed by intermediaries who do not give advice. We recommend that all intermediary sales should be advised.

Q17-21: No comments

¹¹ Edwards, S & Tutton, P. *Set up to Fail: CAB clients' experience of mortgage and secured loan arrears problems* Citizens Advice 2007

6. Disclosure and changing consumer behaviour

Q22: No comments.

Q23: Do you agree that the limitations on the rationality of consumer behaviour in the mortgage market support the case for greater regulatory intrusion?

We agree that until drives to improve financial capability have taken full effect, there is a need for greater regulatory intrusion. Disclosure has, for the most part, failed to encourage rational decision making in consumers, and behavioural economic research supports this analysis. The banking crisis has shown that financial education has, thus far, been ineffective in preventing irrational behaviour in people, so more checks and balances on lending must be a positive step.

Nonetheless, some customers are well aware of the risks of borrowing, but purposefully choose to overstretch in order to acquire a secure home. We re-iterate the point that better, more affordable housing options are needed across all tenures, and the Government must stop promoting the culture of ownership. We also agree that households must take some level of responsibility for their own decisions and there must be greater clarity as to where the obligation to balance risk lies.

Q24: Do you agree that the FSA has a role in preventing the extension of credit to individuals who are unable to afford such high levels of debt?

We agree that the FSA has this role, consistent with its statutory objectives.

Q25: Do you have any comments on the financial capability initiatives designed to support the overall mortgage market reform?

We agree that the FSA must help to enact a cultural shift away from the notion that property ownership is a risk-free, investment opportunity.

We are pleased that the financial capability programme will include a workstream working with free advice agencies. Housing and debt advisers have a unique insight into borrowers' needs, and provide advice in a number of forms, from literature on choosing a mortgage to providing emergency legal advice at court duty desk schemes. We believe that engagement with advice – and early advice in particular - can prevent repossessions. For example, court duty desk advisers

help borrowers to avoid immediate repossession at court in approximately 88% of cases.¹² Therefore continued funding for, and collaboration with, the advice sector is absolutely crucial.

7. Arrears and repossessions

Q26: Do you have any comments on our proposals to strengthen our approach to firms' arrears management practices?

A stronger regulatory stance on arrears and repossessions is long overdue. The FSA's thematic work and our own client case studies and research have repeatedly shown instances of lenders failing to forbear and treat struggling homeowners fairly. We warmly welcome the recent publication of a separate consultation on this issue.

It is essential that any new regulation of arrears management is backed by strong enforcement.

Particular issues we would like to see addressed in the existing Mortgage Conduct of Business rules (MCOB) are as follows:

- MCOB does not take account of state help or private mortgage insurance (SMI or MPPI), nor of other government schemes, such as Mortgage Rescue (MRS). We believe it is right that lenders should cooperate with these schemes and forbear accordingly to allow applications.
- MCOB frequently uses terms like 'fairly' and 'reasonably' without much by way of definition. This gives lenders the ability to define 'excessive' or 'fairly' in a way that suits them. More prescriptive, binding rules would promote consistent standards across the lending industry and give borrowers a much clearer idea of what to expect.
- MCOB does cover arrears charges but doesn't specifically state that it is unreasonable to continue to add default charges when the borrower has agreed a new repayment plan with the lender and is keeping up with this. Default charges just add more and more debt to people who are already struggling, and are particularly unfair if a repayment plan has been negotiated. Some will charge standard fees for every letter or call regarding arrears. We strongly support the banning of default charges.

¹² *Turning the tide? Evidence from the free advice sector on mortgage and secured loan possession actions in England in July 2009*, AdviceUK, Citizens Advice, Shelter, December 2009

- MCOB does not require lenders to publish their arrears policies. This makes it difficult for advisers or consumers to challenge them in possession cases and does not promote transparency. FSA should require lenders to publish their policies.

8. Unfair charging practices

Q27: Do you consider that the mortgage market fees and charges reflect the underlying costs or are consumers paying excessive charges?

Further data analysis is required to compare fees and charges to actual costs incurred – although the wide variation within different firms' charging practices indicates that there is at least some level of over-charging on certain fees.¹³ However, anecdotal evidence suggests that borrowers do not tend to consider fees and charges when choosing a loan, so lenders may be able to charge excessively without major damage to their reputation.

Evidence from our research into arrears management found that charges could be more acutely felt by borrowers struggling to repay:

"In a few cases, a third of the total arrears accrued were made up of penalty charges. In one instance, a borrower had had a suspended possession order awarded against her on terms of the contractual mortgage payment, plus £50 a month to make up the arrears. At the same time, a further £50 a month was being added to her account in the form of arrears charges, making it impossible for her to rehabilitate her account on those terms. One key player was concerned about marginal lenders who gave the appearance of forbearing, but in fact their business models were predicated on the basis of the income stream from mortgage arrears charges."¹⁴

Q28: What would be the impact of consumers not being allowed to roll up intermediary fees and product charges into the mortgage loan?

Charges and fees should be set out clearly, and shown as distinct from the mortgage itself. We agree that paying fees upfront would help consumers to consider the true price of charges. On the other hand, rolling fees up into the loan can help to spread cost over time. Further data is needed

¹³ Written evidence submitted by Which? to the House of Commons Treasury Committee: *Mortgage arrears and access to mortgage finance: Fifteenth Report of Session 2008-09*, August 2009.

¹⁴ Ford, J, & Wallace, A., *Uncharted Territory? Managing mortgage arrears and possessions*, Shelter, July 2009

on intermediary fee levels, how these are currently paid and the financial impacts of spreading the payments (for example, whether or not interest is added).

9. Scope extensions

We believe that the system of dual regulation for first and second charge mortgages, and the lack of regulatory oversight in buy-to-let, have been detrimental to consumers. We strongly support extension of FSA scope to cover these areas, and will be responding to the HM Treasury consultation paper on the issue accordingly.¹⁵

Second charge lending

Our research¹⁶ has suggested that second charge lenders do not always treat borrowers in arrears responsibly and sympathetically:

- National Debtline callers with mortgage or secured loan arrears were surveyed about how their lender(s) had responded to the situation. 57% of those in arrears with their mortgage were satisfied with the way they were treated by their lender compared to only 34% of those in arrears with their secured loan.
- One court duty desk adviser surveyed commented that *"Secured loans, with sub prime lenders, are the most problematic.... They are the prime reason for my attendance at court"*

There is wide ranging consensus that second charge lending should be regulated by the FSA. We endorse this proposal because:

- At present, OFT and FSA both seek to regulate the same sorts of issues across lenders in slightly different ways. Both existing regulatory systems have different strengths and weaknesses. This can mean a lack of clarity and consistency of practice across the mortgage market, and confusion for consumers.
- If the FSA introduces tougher lending criteria in the first charge residential market, it would make little sense if the second charge market did not adhere to the same standards.
- Regulating both markets should improve the FSA's ability to oversee financial markets.

¹⁵ *Mortgage Regulation: A consultation*, HM Treasury, November 2009

¹⁶ *Mortgage and secured loan arrears: Adviser and borrower surveys*, AdviceUK, Citizens Advice, Money Advice Trust, Shelter, April 2009

However, we believe that a singular, strong regulatory framework should take account of the differences between first and second charge lending and encompass the best consumer protections of both OFT and FSA regulations, particularly the ability to use time orders. There is also a need to consider how unsecured lending should be correspondingly regulated.

Buy-to-let

We believe that buy-to-let mortgages have fuelled the notion of property as investment, and contributed to inflation of house prices – often to the detriment of would-be owners. Particular problems in this market include:

- With little by way of affordability checks or scrutiny of business plans, amateur landlords were allowed to enter the market despite having no credentials for how they would manage their finances, or indeed their tenants. This failure to ensure lending was sustainable has led to an increase in landlord mortgage arrears and repossessions – with obvious detriment to tenants who may have to move home if their landlord defaults.
- Recent Shelter research into the effects of the recession on the private rented sector showed that around 1 in 10 landlords were constantly struggling or falling behind. Of newer landlords – those who entered the market less than five years ago – this rose to more than half.¹⁷

There are challenges to regulating this market, and some parties view buy-to-let very much as an investment rather than a home loan. But we believe that a loan is a loan – and lenders should always be obliged to ensure it is affordable. The FSA notes that other EU countries do not distinguish between regulation of residential loans and (equivalents of) buy-to-let, and we see no reason why this could not be replicated in the UK.

10. Other matters for discussion

Protecting consumers when mortgage books are sold on

We agree that the FSA must intervene when lenders – particularly defunct lenders – have sold mortgage books on to unregulated firms such as hedge fund investors. We identified this problem in our research report 'Uncharted Territory' in July 2009:

¹⁷ *Taking the strain: The private rented sector in the recession*, Money Advice Trust & Shelter, November 2009

“There were some concerns about forbearance in situations where specialist lenders had sold on their mortgage books, sometimes to investment companies whose core business was not mortgage lending”. One borrower interviewed, whose loan had been sold on, encountered difficulties with the new company: “This new lender sent automated arrears letters... but the lender did not respond to the borrower’s letters requesting to take up these options... the lender was unable to provide a person to help”.¹⁸

We are pleased to see that HM Treasury has now issued a consultation proposing to allow the FSA to intervene in these situations, and we hope that legislation to broaden FSA scope can be introduced quickly.

Q29: Do you agree that the FSA should collect data to enable us to track arrears and repossessions cases back to the original product transaction on a permanent basis? What would be the costs imposed on the market?

We agree that this data would be a useful source of information and should be collected on a permanent basis.

Q30: Do you agree the FSA should standardise some existing industry definitions such as sub-prime? And if yes, are there any existing definition issues other than sub-prime?

We agree that standardised definitions would allow better data analysis. These must be used consistently across all data collecting or analytical bodies (such as lender trade bodies) if the exercise is to be meaningful. We recommend that alongside standardising the definition of ‘sub-prime’, the FSA also considers the definitions of:

- ‘voluntary repossessions’
- ‘non-prime and near-prime’

Q31- 32: No comments.

Q33: Do you agree that the cumulative effect of the policy levers as outlined within our DP will have a positive effect on;

- (i) the equity release market;

¹⁸ Ford, J, & Wallace, A., *Uncharted Territory? Managing mortgage arrears and possessions*, Shelter July 2009

No comment.

(ii) the right to buy market

We agree that right to buy homeowners are often more likely to be in arrears or facing repossession. In addition to the evidence cited in the review:

- Recent research by Consumer Focus found that Right to Buy homeowners were twice as likely as others to have had problems paying their mortgage in the last three months
- Unlike Social HomeBuy there is no assessment of tenants' ability to borrow and own under RTB, meaning that many may find themselves more vulnerable to the risk of default
- There have been numerous examples of specialist property companies exploiting the scheme, for example by doorstep selling of mortgages to vulnerable tenants, or acquiring portfolios of former social homes to rent out privately.

Therefore we agree that more stringent affordability checking is required in this area.

Outstanding issues

Mortgages for Low Cost Home Ownership (LCHO), including both shared ownership and shared equity schemes, are scarce, offered by only a handful of lenders. Loans are usually 100% LTV and some lenders classify them as sub-prime. There is a danger that the proposals in the Mortgage Market Review will further constrain this kind of lending, which could increase levels of unsold LCHO units. We recommend that the FSA works with lenders and the Homes and Communities Agency (HCA) to ensure that any new lending rules do not hinder new housing development or scheme uptake.

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