

JOINT COMMITTEE ON THE DRAFT FINANCIAL SERVICES BILL CALL FOR EVIDENCE

Shelter evidence, September 2011

Summary

- Reckless mortgage lending, permitted by lax regulation, contributed to the scale of the financial crisis and severe detriment to thousands of home owners.
- Shelter is therefore strongly supportive of the government's proposals to strengthen the regulatory framework for financial services. We believe the regulators' new powers will support a much more effective response to poor lending practice.
- We urge the draft bill committee to ensure these proposals are not watered down, and to consider further measures to more effectively prevent future financial crises.
- In addition to providing evidence in support of existing proposals, our response sets out the case for the following measures:
 - Extension of regulation to buy-to-let mortgages
 - Transfer Consumer Credit Act regulation to the FCA to include second-charge mortgages, with some CCA protections extended to residential mortgages
 - Strengthened consumer protection objectives for the FCA.

Why is Shelter interested in the Financial Services Bill?

Shelter is a national campaigning charity that provides practical advice, support and innovative services. We help more than one million people a year via our website, helplines and national network of services.

Shelter is interested in the Financial Services Bill because we know that poor financial regulation led to reckless mortgage lending, with severe consequences for individual borrowers, the housing market and the wider economy. As such, Shelter broadly welcomes the consumer protection proposals set out by the government in the draft legislation, which we believe could help to prevent the scale and the severity of the lending practice we witnessed in the build up to the financial crisis.

Reckless mortgage lending saw many thousands of households leant mortgages that they had no hope of ever paying back, placing borrowers in dire financial straits. The practice of securitisation, where mortgage books were sold on to unregulated third parties who had no obligation to forebear struggling borrowers, led to macro-economic instability and also direct consumer detriment. Over 150,000 households have had their homes repossessed since 2007.¹ Meanwhile, new research by the Consumer Credit Counselling Service finds that 11% of all mortgage accounts are in some kind of financial distress.² This has also resulted in high costs for the tax-payer, with each repossession costing the state up to £32,000,³ as well as high contributing to legal aid costs.

¹ Council of Mortgage Lenders, Quarterly repossession statistics

² Consumer Credit Counselling Service, Debt and household incomes report, 2011.

³ Shelter, Policy Briefing: Mortgages and Repossessions, January 2008

Shelter believes mortgages are a striking example of how poor regulation of lender practice has harmed individual consumers and the wider economy, particularly as residential mortgage lending makes up 86% of all lending to individuals in the UK.⁴ Mortgage lending should act as a powerful precedent when parliamentarians assess the effectiveness of both prudential and conduct regulation set out in the draft legislation.

Shelter is not directly about the full range of financial services regulation; our interest lies in whether the regulatory tools will prevent the conduct and prudential practice of lenders that causes direct detriment to borrowers and wider negative effects on the housing market. As such, our response to this call for evidence will focus on questions relating more directly to mortgage lending.

9. Can Parliament take an informed decision about the proposals for the FPC without details of the macro-prudential tools at its disposal?

Shelter encourages the committee to actively consider the potential benefits of the FPC's mooted tool of setting maximum loan to value ratios for reasons of macro-economic stability. While lenders are generally cautious at present, the effects of widespread high LTV mortgages in the run up to the credit crunch arguably over-inflated up house prices,⁵ while leaving borrowers more vulnerable to negative equity if the value of their home decreased.⁶ The Bank of England sets out that this can make banks vulnerable where sufficiently widespread negative equity impairs their capital ratios.⁷

It is important to be clear that these measures are no substitute for responsible lending conduct rules, but do offer the FPC strong emergency powers to protect the integrity of the economy. It would also be necessary to ensure that there were safeguards to prevent against any negative consequences, such as all lending temporarily drying up.

15. Are the FCA's primary objectives appropriate? Is significant emphasis given to the promotion of competition?

Shelter believes that a sustainable financial system is one that starts with the best interests of consumers and the wider economy, and we are pleased that the Treasury has highlighted consumer protection as a key principle for the new regulatory framework. Consumer Focus research highlights that the overall culture of a regulator is central to the effectiveness of regulation.⁸ We believe this should start with strong principles set out in legislation.

Shelter does not consider the wording of the consumer protection objectives as it stands in the draft bill to deliver on Ministers' ambitious vision. We believe a stronger objective, similar to Ofcom's consumer protection objective,⁹ would send out a stronger message to the regulator about

⁴ Bank of England, 2011. Statistical release: Lending to individuals: June 2011.

⁵ Heitor Almeida, Murillo Campello, Crocker Liu. The Financial Accelerator: Evidence from International Housing Markets, Review of Finance (2006) 10: pp. 1–32.

⁶ Gudmundur Gudmundsson, Risks in higher loan-to-value ratios of housing. Monetary Bulletin 58, 2005.

⁷ Bank of England, Quarterly Bulletin 2009 Q2, The economics and estimation of negative equity.

⁸ Fair enough? A report to Consumer Focus from the National Consumer Federation on the FSA's Treating Customers Fairly initiative. 2011.

⁹ Section 3(4) of the Communications Act 2003

the necessary culture shift, and allow consumers and consumer groups to hold them to account against this objective, particularly around protection for vulnerable consumers.

16. Are the responsibilities of the FCA towards the regulation of markets appropriate?

Shelter welcomes the new powers proposed in the draft bill. In particular we support the powers to ban detrimental products and to publicise investigations into firms' practices. We believe these have the potential to be effective in stopping early detriment to consumers as well as sending out a clear message to lenders that they cannot get away with lending practice that causes serious detriment to consumers.

The power to ban detrimental products could see the removal of products that put vulnerable borrowers at risk of homelessness before they cause widespread detriment and pose significant macro-economic risks.

For example, this could have prevented Sale and Rent Back products from causing significant detriment to consumers earlier, before they were brought within FSA regulation.¹⁰ In this instance, Shelter advisers were seeing significant numbers of cases where vulnerable homeowners were facing eviction after taking out these often exploitative products, but it took two years for the FSA to bring them within their regulatory framework and a further year for sufficiently robust rules to come into play. This caused prolonged and unnecessary anguish for consumers.

We would urge parliamentarians to consider whether the current proposals to only ban products within the FCA's existing regulatory framework are sufficient, and whether a fast-track process could be instigated to allow FCA to bring wholly unregulated products, such as 'Sale and Rent Back', within their regulatory framework. Shelter believes this additional power would further enshrine a more proactive approach for the regulator, and prevent similar problems occurring in the future.

The new transparency powers for the FCA, through naming and shaming reckless lenders, can be a strong support for improving practices, protecting consumers, and changing culture across the financial services sector.¹¹ It is important that this measure has teeth, although we note that the Treasury has already made significant concessions to lenders on safeguards against undue publicity. We would urge the committee to consider whether the detail of the draft legislation gives too strong a ground of appeal that it will fail to act as a major disincentive to lenders.

17. Does the draft Bill strike the right balance between the responsibilities of consumers and firms? Are the FCA's new powers in the area of consumer protection appropriate?

¹⁰ 'Sale and rent back' or 'mortgage rescue' companies offer struggling homeowners the chance to stay in their homes when they can no longer afford their mortgage. The property is bought and rented back to them by the company. Before the FSA began regulation of the sector in July 2009, some companies took advantage of people's desperate circumstances by buying properties at much less than their market value, putting up rents to unreasonable levels or even evicting tenants from their own home for no reason.

¹¹ Consumer Focus, 2009. Rating Regulators.

The examples of sub-prime mortgage lending and payment protection insurance have shown that lenders have targeted vulnerable consumers with complex and risky products that were thoroughly inappropriate for them. With regard to mortgage lending, the apparent insecurity of private renting compared to owner occupation and the shortage of social housing, meant that many households were driven to buy a home when they could hardly afford to maintain their mortgage payments.¹² The factors that push consumers to take out financial products are much more complex than the consumer responsibility argument allows.

Furthermore, consumers are subject to significant asymmetries with lenders. Lenders are technical experts in their products, whereas consumers are generally not experts in financial services and do not, for example, have access to interest rate forecasts. An Office of Fair Trading survey found that only a quarter of consumers will read the small print.¹³ While consumer responsibility is important and we support the role of ongoing consumer education programmes through the Money Advice Service, we believe that to address short and medium term micro and macro-economic risks, the principal responsibility should be on lenders to ensure that they do not market and target their products at inappropriate groups.

22. Does the draft Bill contain any proposals or omissions, not covered by the questions above, which cause concern?

Shelter believes the committee should consider whether the proposals in the Bill go far enough to improve the practice of lenders and prevent further consumer detriment and macro-economic risk.

Regulating buy-to-let (BTL) mortgages.

We believe it is important for the Treasury to consider carefully how it defines 'participants at the sophisticated or professional end of the spectrum', particularly where this applies to BTL lending. BTL mortgages have recently been disproportionately subject to arrears and repossession,¹⁴ and the vast majority of landlords are individuals or couples with fewer than 3 properties.¹⁵ This suggests that many BTL borrowers have more in common with consumers than businesses and would benefit from more effective protection and regulation. Meanwhile, a lack of proper protection could place large numbers of tenants at considerable risk of losing their home.

Transfer of Consumer Credit Act responsibilities from OFT to FCA

The Treasury has considered transferring the responsibilities for Consumer Credit Act (CCA) responsibilities to the FCA from the Office of Fair Trading (OFT). Shelter strongly supports this move, along with a transfer of certain CCA legal protections to mortgages. This change would provide greater protection for consumers as well as further promoting culture change among lenders.

¹² Citizens Advice, 2009. Set up to fail: CAB clients' experience of mortgage and secured loan arrears problems

¹³ Office of Fair Trading, Consumer Contracts, 2011.

¹⁴ Council of Mortgage Lenders: Table AP7 - Possessions, buy-to-let and owner occupied markets. Published 6 August 2010.

¹⁵ Professor Julie Rugg, The Private Rented Sector: its contribution and potential, 2008

The main benefit of this transfer would be bringing second charge mortgages¹⁶ within the same regulatory framework as residential mortgages. At present, the OFT and FSA both seek to regulate the same sorts of issues 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. While second charge mortgages were due to be transferred to FSA regulation, this move is now in question by the Treasury.

Second charge mortgages are disproportionately subject to repossession, with analysis of a sample of 452 possession cases in English county courts, 16% of cases were being brought by second-charge lenders.¹⁷ This appears to be disproportionate to the market share of second-charge lenders.

Furthermore, a transfer of some of the more effective CCA regulatory tools, such as Time Orders, would be a welcome tool for challenging hasty repossession by residential mortgage lenders.

There are also small amendments to mortgage law that would close loopholes that allow lenders to repossess a home without obtaining a court order. We would strongly welcome the Government taking sensible action to close these.

¹⁶ Second charge mortgages or secured loans are when a loan is secured against a mortgage. As the loan is secured against the mortgage, if the borrower defaults on the loan, they risk having their home repossessed.

¹⁷ 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