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Response to Consultation Document: Mortgage Market Review: Responsible Lending Consultation

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1.0 Background

1.1 Housing Rights Service was established in 1964 and is the leading provider of independent specialist housing advice services in Northern Ireland. We believe everyone has the right to a decent safe affordable home.

Our services include:

- Providing a housing advice line
- Undertaking advocacy and legal representation on behalf of people with housing problems
- Providing a specialist Mortgage Advice Debt Advice Service pilot for people who face losing their homes through debt
- Providing online advice through our award winning website www.housingadviceNI.org and an email advice service
- Providing a specialist housing advice service within the prisons
- Delivering a skills and knowledge based training programme
- Producing information resources materials
- Supporting (In partnership with Citizens Advice and AdviceNI) generalist advice agencies to deliver high quality housing advice in their local communities
- Providing client based comment to influence the development of relevant public policy and legislation
- Providing practical advice and assistance at court for possession proceedings and undertaking preventative policy work through our Preventing Possession Initiative.

All our services are delivered throughout NI and focus on the key areas of preventing homelessness; accessing accommodation; tackling poor housing conditions and affordability.

Funding for our work comes from a range of different sources. Our core services are funded by the Housing Division of the Department for Social Development NI.

1.2 The organisation first became involved in the provision of money advice and debt counselling in the early 1990s when interest rates, and the number of homes being repossessed, were at record levels. As the primary purpose of our organisation is preventing and alleviating homelessness, our debt advice is only available to clients who have a housing related debt (i.e. *mortgage/ rent or rate arrears*). The service provided is, however, holistic and takes into account all the client's outstanding debts.

In February 2009, Housing Rights Service launched its new "Preventing Possession Initiative." This initiative adopts a twin track approach to preventing homelessness as a consequence of debt-related possession. Firstly, an in-situ court representation service is available for homeowners and tenants facing possession. This seeks to make advice available, free of charge, to people facing the imminent threat of repossession, who do not have their own legal representation and who have not engaged with an advice agency prior to the court date. There is also a policy element to the project. Through engagement with government, lenders and landlords we aim to reduce the likelihood of possession actions being initiated in the first instance and to ensure that viable housing options are available for those at risk of losing their homes.

In May 2009, Housing Rights Service launched The Mortgage Debt Advice Service (MDAS) as a pilot initiative. MDAS has helped over 900 people since it began in May 2009. The aim of MDAS is to prevent people in Northern Ireland from becoming homeless as a result of housing debt. This aim is achieved through:

- Providing specialist debt advice and, where necessary, representation to prevent repossession; and
- Assisting those who are not able to retain their home to find suitable alternative accommodation.

1.3 We welcome this opportunity to respond to this Consultation paper: The Mortgage Market Review: Responsible Lending. Housing Rights Service is supportive of the Financial Services Authority's (FSA) approach to combat irresponsible lending practices and encourage lenders to ensure that mortgage products sold to consumers must be appropriate and affordable.

2.0 General comments

Financial crisis and debt are important triggers to homelessness which has a devastating effect on families. Housing Rights Service statistics indicate that in 2008/09, there was more than a 500% increase in the number of clients our advisers represented at possession proceedings in court compared to the previous year. Regrettably, in our view, a significant number of these hearings could have been avoided if a more effective regulatory framework had been in place to constrain risky lending and unaffordable borrowing. In light of this, we made our responses to: Mortgage Market Review, Mortgage Market Review: Arrears and Approved Persons and Responsible Lending (interest-only mortgages) consultations.

Housing Rights Service has long advocated for better regulation of mortgage service providers, particularly sub prime lenders and intermediaries, to promote responsible lending and marketing practices. It is vital that mortgage providers lend responsibly; ensuring consumers are borrowing in accordance with their income and ability to repay. Housing Rights Service believes that some of our clients would not be in the situation they are currently in if responsible lending practices and appropriate affordability assessments had been conducted at the outset. In fact, had the proper checks and balances been in place, a number of our clients would not have qualified for mortgages in the first place.

Our comments in response to this consultation paper are focused on consumer protection and based on the experience of our clients. We have tailored our response to comment on issues we feel are within our scope and expertise. We very much support a more responsible approach to lending, to ensure a sustainable market and one that works better for consumers. Housing Rights Service also believes that a robust and effective assessment of individual affordability has to underpin any approach to responsible lending.

3.0 Specific responses

Q1. Do you agree with our proposals for income verification?

Housing Rights Service supports a robust approach to income verification and believes in the vast majority of cases all consumers should be required to evidence their income. However, in our previous response to the Mortgage Market Review consultation, we felt the FSA needed to consider exceptional circumstances where there are consistent problems verifying income, for example self-employed construction workers and taxi drivers who may not have wage slips and whose income varies.

Housing Rights Service welcomes the FSA's approach, that although lenders will be required to verify income for all applicants, the FSA does not intend to prescribe the sources lenders use to verify income. We believe that this flexibility concerning possible sources of evidence for self-employed consumers will help alleviate the difficulties that they can face in relation to income verification. However, lenders must ensure that this flexibility is not open to exploitation and that all possible sources of evidence are from a reputable source and provide accurate income verification.

Q2. Do you agree with our approach to assessing income?

Housing Rights Service welcomes the FSA's approach refraining from being prescriptive around the types of income a lender may take into account when assessing affordability. However, lenders must ensure that they verify the plausibility of all income and expenditure to ensure they have an accurate account of the consumer's financial circumstances. We believe that having robust affordability assessments will ensure that borrowers are able to sustain affordable repayments in the long-term.

Housing Rights Service supports the proposal for lenders to consider the variability of income over time in their assessments. We believe that this will help ensure the long term affordability of the loan. However, we would stress that affordability assessments are a snapshot in time and can never really be an exact estimation. There are many factors that can affect a consumer's ability to retain payment over time and cause financial difficulties such as: relationship breakdown, unemployment or a 'life event,' which can affect any consumer regardless of income.

Q3. Do you agree with our approach to assessing expenditure? Do you foresee any practical issues?

Housing Rights Service welcomes the proposal that lenders should take expenditure into account when assessing affordability, including the servicing of debts and general expenditure. We believe, in order to ascertain an accurate picture of affordability, lenders must implement a holistic approach to a consumer's financial circumstances. Our debt advisers currently assess affordability on the basis of income and expenditure and, similar to the FSA proposals, they include contingency expenditure to make allowances for any unforeseen expenditure. It is imperative that affordability assessments are robust to ensure, as far as possible, that consumers will be able to meet their current and future repayment obligations, without recourse to further debt relief or rescheduling.

In terms of practical issues, Housing Rights Service would encourage the FSA to ensure that there are more stringent compliance regimes in place to ensure that these proposals will be effectively implemented. For enforcement to be effective, it must be sufficiently resourced. The lenders must have the tools to assess expenditure as well as outstanding credit commitments the consumer may have.

Q4. Should lenders be required to ensure that credit commitments being cleared by debt consolidation are repaid as expected? Would there be any significant additional costs in implementing this for further advances?

Housing Rights Service believes this proposal is too interventionist. We feel that this proposal would require the lender to actively interfere in the financial affairs of the borrower and become too intrusive.

Housing Rights Service feels that this proposal goes beyond the scope of responsible lending. The primary issue should be whether or not the mortgage is affordable, both in the short-term and the long-term, for the consumer. We feel this proposal does not relate to the lending criteria or the tightening of the criteria to ensure there is both responsible lending and borrowing.

Housing Rights Service does not have the relevant expertise to comment on the possibility of additional costs being incurred as a result of the implementation of this proposal.

Q5. Do you agree with our approach to calculating free disposable income?

Housing Rights Service supports the approach to calculating free disposable income. We believe that in order to get an accurate picture of affordability, assessment must consider the consumer's free disposable income (i.e. income net of all expenditure). We welcome the 'calculation of free disposable income' (displayed at Exhibit 2.7 of the consultation paper) which reflects the information which our debt advisers use when drawing up a financial statement.

Q6. Do you agree that affordability should generally be calculated on a capital and interest basis?

Housing Rights Service believes that assessing a loan on a capital and interest basis is the most reasonable method of assessing the consumer's long term sustainability to maintain mortgage repayments. There must be a robust affordability assessment to ensure a mortgage is only deemed affordable if its level and terms allow the consumer to meet current and future payment obligations. Our belief that this is the right approach is based on the experiences of a significant number of our clients who were granted an interest only mortgage because they could not afford a repayment mortgage. Even a slight change in circumstances leaves such borrowers vulnerable to default . These borrowers do not have the option of reducing payments by temporarily switching from repayment to interest only as they are already on an interest-only mortgage. This restricts a borrower's options and limits the availability of short-term coping mechanisms to manage with (temporary) financial difficulty.

Q7. Do you agree that affordability should be assessed on a maximum term of 25 years?

Housing Rights Services agrees that a standard 25 year maximum term should be used to assess affordability, to ensure a mortgage is only deemed affordable if its level and terms allow the consumer to meet current and future payment obligations. However, we believe this policy should be reviewed regularly to take into account changing external factors such as: increasing life expectancy;; changing patterns in the labour market; and the potential for a higher state pension age threshold.

Q8. Do you agree with our approach to testing affordability against future interest rate increases, based on swap rates or any other appropriate guideline rate? Can you foresee any practical issues in the FSA setting a guideline margin for firms to use?

Housing Rights Service welcomes the approach to testing affordability against future interest rate increases. We believe that this would be beneficial in assessing and informing the consumer about his/her affordability capacity in the long-term, should their financial circumstances change or interest rates rise. We agree that it is imperative that any margin is assessed over time and is not set too low or unreasonably high, thereby restricting affordability for consumers.

Housing Rights Service supports the FSA's view that testing at a rate of 2% above the lender's standard variable rate would not offer sufficient flexibility to take account of economic circumstances. We welcome the proposal that the FSA should publish a guideline margin for firms, however, require further information about how this is going to be set and reviewed. Housing Rights Service would be concerned if the guideline margin was only reviewed quarterly given the fact that the Bank of England reviews the bank rate on a monthly basis. This could potentially affect consumer's affordability negatively if the rate was to decrease suddenly and the FSA guideline margin was higher.

Although we support the proposal to test affordability against future interest rates, we would request that the FSA conduct further research into this proposal to ensure they are able to provide evidence as to an appropriate guideline margin.

Q9. Do you agree with our proposal to impose an additional buffer on the calculation of free disposable income to protect credit impaired borrowers? What would be an appropriate basis for that buffer and how should it be set?

Housing Rights Service acknowledges the need to protect credit impaired borrowers from entering into substantial, financial commitments, which they may not be able to sustain. However, we are concerned that an additional buffer will severely curtail the ability of credit impaired consumers to borrow, potentially pushing them towards the sub-prime sector.

Housing Rights Service is concerned that the following condition (outlined in section 2.64 of the consultation document) may potentially affect a large number of borrowers:

“within the last two years, has had a sum equivalent to three months’ payments overdue on a mortgage or other loan (whether secured or unsecured), except where the amount overdue reached that level because of late payment cause by errors by a bank or other third party”

Although Housing Rights Service understands the disproportionate levels of arrears in the credit-impaired sector, we are concerned about the detrimental effect this may have on credit impaired consumers. We would like further clarification on the research supporting the statement that 52% of consumers who sought advice relating to arrears on their mortgage or secured loan had a debt that might not show up in a credit record. What category of debts did not show up on a credit record?

Credit impaired borrowers already face higher interest rates than those with a good credit history. We believe there needs to be further evidence to justify implementing a buffer. Although the addition of a buffer may protect credit-impaired borrowers from getting themselves into an unmanageable situation in the future, it could potentially push them away from mainstream lenders and into the sub-prime sector. Housing Rights Service is not satisfied that there is sufficient evidence to justify this proposal and requests further research into the implementation of a “buffer”.

However, transitional arrangements are required to ensure that existing borrowers with credit impairment problems are not left vulnerable to repossession because they cannot remortgage.

Q10. Do you agree with our approach to lending into retirement?

Housing Rights Service welcomes the FSA's approach to lending into retirement. We agree that there should not be a restriction on lending into retirement, as retirement age is steadily increasing with people being expected to work longer. However, Housing Rights Service does acknowledge there may be some impact on older consumers in relation to lending into retirement age. It may be difficult for a retired consumer to verify income into retirement and to ascertain whether the mortgage is likely to be affordable. Nevertheless, lenders must satisfy themselves that the level of income in retirement will be sufficient for the mortgage to remain affordable. However, we would ask the FSA to provide further clarity as to what information a lender should use to accurately verify income into retirement.

Q11. Are there specific atypical lending circumstances which you think merit an alternative approach to the assessment of affordability rather than being addressed through the possibility of rule modifications or waivers?

Housing Rights Service believes there may be specific, atypical lending circumstances that merit an alternative approach, however, careful consideration needs to be given to how this would be enforced. There is a need to define customer types and the conditions attached alongside this to ensure this type of mortgage product is not open to exploitation for all consumer groups.

Exploitation of interest-only mortgages, without any firm repayment vehicle in place, is one of the reasons so many consumers are struggling to maintain their mortgages. In order to prevent this happening again, there is a need for safeguards to ensure interest-only products are only offered to specific customer types who have demonstrated affordability within specified conditions.

Q23. Do you agree that our enhanced affordability assessment will be sufficient to address the risks to individual consumers from equity withdrawal?

Housing Rights Service endorses the FSA's view that, whilst there are negative consequences for some consumers who borrow against the equity of their home, there are benefits as well. In light of this, it is important to balance both the benefits and the risks of equity withdrawal. We believe there must be strong evidence to warrant limiting the amount of equity a consumer can withdraw from their homes which has not been evidenced by the FSA. As a result of this, we welcome the FSA's proposal not to limit equity withdrawal at this time, but to keep it under review.

Housing Rights Service stated in our previous response to the Mortgage Market Review that we believed lenders could be more responsible when lending on the strength of equity and that this does warrant some level of regulatory intervention. Until enhanced affordability assessments are fully implemented, we believe it is impossible to fully ascertain whether these will be sufficient to address the risks of individual consumers from equity withdrawal. However, Housing Rights Service feels they should go some way in addressing the risks posed by equity withdrawal.

Q25. Do you agree that we should not ban loans to borrowers with multiple high-risk characteristics but instead rely on robust affordability assessment requirements (including additional checks when the borrower is credit-impaired)?

Housing Rights Service previously indicated in our Mortgage Market Review response that we would be in favour of prohibiting the sale of mortgages to borrowers with multiple high-risk characteristics. However, we stated we did not want to be too prescriptive at that stage, particularly given that the FSA's analysis of what causes high default rates is not yet complete.

Our experience shows that in Northern Ireland many consumers were sold inappropriate mortgage products, often through intermediaries working in the sub-prime sector. Housing Rights Service identified some unscrupulous intermediaries, spurred on by attractive commission, who were not always thorough when it came to checking whether products were affordable for individual consumers.

The outcome of the FSA's findings show the dominant characteristic present in all of the highest-risk lending combinations is whether the borrower has an impaired history. We agree with the FSA that it would be too blunt an approach to place an outright ban on some or all high risk products which could unfairly deny some borrowers a mortgage without being assessed for their ability to repay. However, Housing Rights Service believes, in the absence of a ban, the FSA must ensure robust affordability assessments are implemented and proactively enforced throughout the mortgage market. Lenders and intermediaries must ensure that borrowers are able to sustain affordable repayments in the long term.

However, as stated above, Housing Rights Service has reservations regarding the proposal to have an additional "buffer" for credit-impaired consumers and has requested further research into this proposal.

Q27. Do you agree that we should amend MCOB 13.3 to limit the number of times fees for missed payments are charged?

Housing Rights Service fully supports the proposal to strengthen MCOB 13.3 by limiting the number of times fees for missed payments can be levied. We agree that it is unreasonable and unfair to continue to take payments from a borrower in arrears more than twice a month. Housing Rights Service believes that unnecessary and excessive arrears charges are a significant problem within the mortgage market. These charges unload further financial burden on consumers who are already struggling to clear existing debts. Subsequently, such excessive charging has often made it impossible for the debtor to service the debt.

Housing Rights Service considers a lack of prescriptive rules in relation to arrears charges as a major contributor to the unfair treatment of consumers. In our experience, there is poor consumer understanding of arrears statements because of various component charges and how they are levied. This is further perpetuated by the inconsistent approach taken by the mortgage industry. Housing Rights Service believe there needs to be a more standardised approach amongst firms in relation to arrears statements. We believe there should be uniformity of language in relation to arrears statements and a focus on streamlining the plethora of different arrears charges.

We would therefore urge the FSA to ensure that there is total clarity regarding the rules applicable to arrears charges and that these rules are implemented robustly. We believe this amendment will help prevent consumers accruing excessive charges when in arrears. However, the FSA must make certain that this policy is proactively enforced to ensure that all lenders comply with the amended rules.

Q30. Do you agree that we should widen MCOB 12.4 and 13.3 so it applies not just to arrears but to all payment shortfalls?

Housing Rights Service welcomes the FSA's approach to strengthening and widening MCOB 12.4 and 13.3 to apply to all payment difficulties, not just arrears. We believe the current rule, under MCOB 12.4 is restrictive as 'arrears' is defined as a shortfall equivalent to two or more payments and we believe this restriction can allow lenders to front-load arrears charges into the first month to avoid MCOB rules. By amending this rule, lenders will be brought within the scope for all payment shortfalls and any charges that are made must be a reasonable estimate of the cost of additional administration.

Housing Rights Services supports the widening of MCOB 13.3 to place a duty on lenders to deal fairly with any customer who has a payment shortfall. Replacing the word "arrears" with "payment shortfall" ensures that all customers are treated fairly, regardless of whether the customer has one payment shortfall or two. In our experience, if payment difficulties are addressed as early as possible by the lender, a client can more effectively manage their way out of debt. Fundamentally, we believe it will help alleviate the burden on indebted consumers who are struggling to manage arrears payments, due to ever increasing arrears charges.

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