

HM TREASURY MORTGAGE REGULATION: A CONSULTATION

Response by the Money Advice Trust (February 2010)



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INTRODUCTION

About the Money Advice Trust

The Money Advice Trust (MAT) is a charity formed in 1991 to increase the quality and availability of money advice in the UK. We work with the UK's leading money advice agencies, government and the private sector to increase the availability of money advice, improve its quality, and enhance the efficiency and effectiveness of its delivery.

MAT's vision is to reduce levels of unmanageable debt by:

- Ensuring high-quality money advice through training and support for advisers
- Collecting and disseminating information on debt, credit and the money advice sector
- Improving efficiency and effectiveness within the money advice sector via research and policy work
- Providing advice via National Debtline and Business Debtline
- Raising funds for the sector.

How we have drawn up this response

In preparing this response, we have consulted our partner agencies in the free-to-client money advice sector in order to achieve a consensus view. These partners include:

- Advice NI
- Advice UK
- Citizens Advice Northern Ireland
- Citizens Advice Scotland
- Institute of Money Advisers
- Money Advice Scotland
- National Debtline and Business Debtline (when relevant)
- Payplan.

Some of these partner agencies will also submit their own separate responses to this consultation paper. These submissions may include issues not covered below. Please note, our partner agencies may not have provided views on this response where this consultation paper does not cover their specific jurisdiction.

Please note that we consent to public disclosure of this response.

We welcome the opportunity provided by HM Treasury to take part in this public consultation on its proposals to give the FSA responsibility for the regulation of second-charge mortgages; buy-to-let mortgages and consumer protection when lenders sell on mortgage books.

Responses to individual questions

Question 1: Do you agree with the analysis of the second-charge mortgage market?

We are largely in agreement with the analysis of the second-charge mortgage market. However we would take issue with the statement that *“In recent years borrower demand has increasingly been for second-charge mortgages as debt consolidation loans, in particular by borrowers with impaired credit records.”* This statement appears to absolve lenders from responsibility for this state of affairs and we suggest that lenders’ advertising and sales campaigns helped to create the ‘borrower demand’ referred to. We recognise that there has been irresponsible borrowing but would suggest that this is part-and-parcel of irresponsible lending. Many of our clients report having been ‘sold’ unsuitable and unsustainable secured loans as the best way to deal with unmanageable debt (even though, in many cases, the loan that was offered was not even large enough to pay off all of the debt that it was supposed to be consolidating).

Moreover, we frequently speak to clients who, over a period of time, have taken out multiple secured loans to deal with their – already unmanageable – debt; many of whom are now faced with negative equity. These consolidation products were often marketed to a targeted audience and sold as the ‘smart solution’ to unmanageable debt. We would add that many people who withdrew equity from their homes in this way, did not understand the inherent risks and the consequences of default.

We would also add that originally, second-charge borrowing was used primarily to carry out home improvements. The major problems now exhibited by this market seemed to arise alongside the aggressive marketing of secured consolidation loans.

Question 2: Do you agree that extending the scope of FSA mortgage regulation to include the second-charge mortgage market would achieve the Government's objective of ensuring a fair, stable and efficient market for second-charge mortgages?

Whilst we welcome the proposal that the same regulatory regime should apply to all mortgages and secured loans, we do not agree that a simple migration of responsibility from the OFT to the FSA would be enough to achieve the Government's objective. Instead, we would like to see an equalisation of the two markets, based on taking the best consumer protection measures from both the Consumer Credit Act (CCA) regime and that of the Financial Services and Markets Act (FSMA). We suggest that a market that is 'fair, stable and efficient' is a market with consistent and meaningful consumer protection. Such protection must cover pre and post-contractual matters including selling, lending, arrears management and individual consumer redress when things go wrong. We are concerned that it would be a missed opportunity if there was an extension of the scope of FSA mortgage regulation to include second-charges, without incorporating such provision.

Question 3: Do you consider that any further action would be necessary in order to ensure that any transfer of responsibility for regulating second-charge mortgages from the OFT to the FSA would not result in a loss of consumer protection?

We have indicated in our answer to question 2 that our preferred course of action is one that amalgamates the best practices and protections from both regimes. We have outlined below two particular aspects of the CCA regime which we would like to see carried over to the whole mortgage market.

- Widespread lender forbearance has been a very welcome feature of how the mortgage industry has responded to the downturn, however not all lenders are forbearing and there is a need for a universal and consistent approach to temporary payment difficulties. Time orders allow the court to reopen a credit agreement and reduce the contractual monthly instalment and the interest on the loan. They are normally a temporary measure to deal with temporary financial difficulty. It is interesting to draw a comparison between the operation of time orders and the Government's Homeowner Mortgage Support (HMS) scheme. One of the difficulties with HMS is that – like other forms of forbearance - it is in the gift of the lender and a significant proportion of lenders have yet to sign up to the scheme. We suggest that if a 'time order like' scheme had been in place across the mortgage market, we would not have needed to 'invent' HMS.

- The unfair relationships test provides that an agreement may be found to be 'unfair' because of:
 - its terms, or the terms of any related agreement or linked transaction (including payment protection insurance);
 - the way in which the creditor has exercised/enforced rights under the agreement or any related agreement; or
 - anything else done, or not done, by or on behalf of the creditor.

Also the court can take into account all matters it considers relevant and at any stage during the relationship. This means before or after the agreement, or any related agreement, was made, when it was in force and after it has ended. Crucially – and this is where the unfair relationships test provides for significantly greater consumer protection than MCOB - if the court finds the relationship unfair, it has a wide range of remedies at its disposal to compensate or provide redress for the consumer.

In addition to the above we would also point out that there are other features of CCA protection and OFT guidance that either improve upon MCOB or contain elements that are an improvement upon MCOB. We would also like to see these applied to the mortgage market, for example:

- Preservation of the best features of OFT guidance on irresponsible lending and second-charge lending.
- Preservation of the best features of the regulations governing advertisements.
- Cooling off periods.
- Warning boxes on agreements directing the consumer to sources of advice.
- Consumer information sheets (again directing the consumer to sources of advice).
- CCA type regulations around unenforceability.
- Regulation around permissible charges in the event of default or repossession action.
- Best practice around default notices, arrears notices and annual statements.
- Early settlement rebates.

Question 4: Do you believe there are any other ways to mitigate the potential future risks posed by second-charge mortgage markets?

We have welcomed the FSA's mortgage market review discussion paper as a timely exercise and one which we feel will be a major contribution towards protecting the consumer from detriment. If proposals contained within the FSA consultation document are extended to include the second-charge market, this will help to promote sustainable lending and consumer protection and so, lessen the risks posed by the second-charge market. We have summarised measures which we feel are particularly relevant below.

- Regulation to ensure that marketing and sales standards require second-charge intermediaries and lenders to assess affordability and suitability.

- Regulation to prohibit loans exhibiting high-risk characteristics; in particular where layers of risk are a feature.

- Regulation to require the second-charge lending market to assess lending risk based on the ability of the consumer to demonstrate long term ability to repay. This would require lenders to carry out individual affordability assessments based upon income and all outgoings and debt commitments. This would also mean that there is no place in an appropriately regulated and prudential market for non-income verifiable lending in its current incarnation.

- Regulation to clarify that ultimate responsibility for assessing affordability should lie with the lender in all cases.

Question 5: Do you agree with the costs and benefits of the options under consideration in relation to second-charge mortgages, as set out in the Impact Assessment?

We are not qualified to comment on the financial costs and benefits of the options of the proposal as set out in the impact assessment. In relation to the non-monetary benefits of the proposal we would make the wider point that there are benefits for society as a whole, and the public purse, from greater protection for borrowers from poor lending practices and unnecessary or avoidable collection and repossession activity.

- This would contribute towards reducing unnecessary levels of stress and illhealth associated with mortgage debt and mortgage difficulties. This in turn would reduce the use of health services; improve family relationships and reduce the risk of family breakdown. This is illustrated in ‘Debt and Mental Health – What we know? What should we do?’ (Chris Fitch et al, October 2009) which stated:

“Individuals with mortgage payment problems or arrears can experience mental health problems (with estimates between 35 to 80% of this group). The human costs of mortgage or housing debt include: a negative impact on personal identity, invoking uncertainty and impacting on a sense of self; heightened levels of uncertainty; and feelings of stigma, shame and biographical disruption.”

- It would also remove the need for unnecessary expenditure by lenders, consumers, the courts, local authorities, and the advice sector on dealing with the consequences of avoidable mortgage distress.

Question 6: Do you agree that FSA regulation of second-charge mortgages should be limited to lending to individuals and trustees?

We agree that it makes sense to mirror the first-charge residential lending exclusion of business-to-business lending from FSA regulation and therefore agree that FSA regulation of second-charge mortgages follows the existing regime for first-charge residential lending and is limited to lending to individuals and trustees.

Question 7: Do you agree that the proposed new definition of a regulated mortgage contract would include second-charge mortgages and continue to include first-charge residential mortgages in its scope?

We do not feel qualified to comment definitively upon how legally watertight the proposed new definition is. However from a lay, commonsense perspective, it would appear to make it clear that the intention is to include first-charge residential mortgages within its scope.

Question 8: Do you agree that the regulated activities in relation to regulated mortgage contracts should apply to second-charge mortgages?

We agree that the regulated activities in relation to regulated mortgage contracts should also apply to second charge mortgages in future.

Question 9: Do you agree that the exemptions and exclusions that apply in relation to regulated mortgage contracts are appropriate for second-charge mortgages?

We do not feel qualified to comment authoritatively on the exemptions and exclusions that apply to regulated mortgage contracts, or for that matter, their relevance for second-charges.

Question 10: Do you agree with the proposed arrangements for dealing with second-charge mortgages entered into before the date specified in the draft order?

As we have noted earlier, the consultation is silent as to whether or not it is intended to ensure that the important consumer protections within CCA regulation are mirrored in some form for all residential mortgages. If there is an intention to have such protections in place under the proposed regime, we see no reason why the scope extension should not be retrospective. We would also point out that if these provisions are not retrospective, we could have a situation where consumers have – on the face of it – virtually identical loan products (possibly even with the same lender) but which are subject to different regulation. This will cause confusion for consumers and advisers alike. It will also mean that existing non-CCA regulated second-charge loans will fall between the CCA and FSMA regimes. We would point out that these loans often carry the most potential for consumer detriment.

Question 11: Do you agree with the analysis of the buy-to-let mortgage market and the risks of market failure?

In general terms, we agree with the analysis of the buy-to-let market and the risks of market failure. Since the economic downturn, our advisers at Business Debtline have been reporting increased enquiries involving buy-to-let arrears and repossessions. In terms of the latter, it is clear to our advisers that this market has not been working well. We recognise that our evidence on this issue is skewed in that callers will clearly not ring Business Debtline to report how well their buy-to let mortgage was sold to them and how affordable they are finding it! In our

experience therefore, we would say that at best, irresponsible lending and unsustainable borrowing are consistent features of the cases that we come across and at worst we also have anecdotal evidence of collusion and even fraud involving developers, valuers, lenders and borrowers (see our reference to ‘gifted deposits’ below).

Whilst the buy-to let market is currently severely contracted, we note that the CML recently reported growth in the market for the first time in two years. We feel that it is important that this opportunity to introduce meaningful regulation should not be missed.

Question 12: Do you agree that FSA regulation will mitigate the risk of market failure in the buy to-let mortgage market?

We agree that giving the FSA powers over conduct of business and prudential regulation for buy-to-let lending will improve the likelihood of responsible lending and sustainable borrowing and lessen the risk of market failure. We describe below the kind of issues that arise for Business Debtline advisers relating to the buy-to-let market.

- Typically, these calls are from small-scale ‘amateur’ landlords who have obtained mortgages to purchase buy-to-let properties. It may surprise HMT to learn that it is frequently the case that a sole trader calling Business Debtline will hold 15 to 20 properties in their portfolio.

- Our advisers are constantly coming up against the consequences of the historic lack of regulation on the marketing and selling of this form of investment finance. It is clear to our advisers that many buy-to-let borrowers have not had access to risk-based advice, and are ill-prepared for the financial implications of their investment. For example, some entered the buy-to-let market instead of paying into a pension fund. Others stumbled into the buy-to-let market by accident as the mortgage for their home became unaffordable, they moved out and moved into cheaper rented accommodation in the hope that letting out their home would produce an income sufficient to cover the mortgage until times improved. (Although admittedly a significant proportion of these accidental landlords have not notified their lender and retain a residential mortgage.)

- Our advisers report very little evidence amongst their client group of meaningful affordability assessments at the sales stage. Typically, the cases they come across are self-certification mortgages and many lending decisions were based entirely around projected rental income. Given that rental valuations

can be inaccurate (sometimes deliberately so) payment difficulties become inevitable. Business Debtline also reports a small number of cases where 'gifted deposits' were involved. These resulted in the borrower receiving – in reality - a 100% mortgage as the valuation was artificially inflated. Borrowers in this position, also report that the rent they were told they could expect from the property they were purchasing was also inaccurate. In the round, this type of lending and borrowing activity has led to an inherent instability within the market and unsustainable individual transactions.

- Many of our callers get in touch with our service once a receiver has been appointed under the Law of Property Act. Our advisers report that there is a lack of transparency at the sales stage and whilst the mortgage is in force, as to the consequences of missed payments. As many buy-to-let borrowers have only had previous experience of the first or second-charge residential mortgage market, they are shocked to hear of their lack of rights if arrears accrue. This in turn has implications for their tenants whose tenancy is subsequently at risk if the mortgage cannot be paid. Even when arrears are low, few lenders are prepared to agree realistic forbearance options and receivers are introduced very quickly. This – quite rightly – is in order to protect the interests of any tenants, but the other effect is that it does not permit the borrower an opportunity to negotiate arrears repayment arrangement with their lenders. If lenders were required to exercise greater forbearance, more buy-to-let mortgagors would be able to ride out periods of economic difficulty and tenants could remain undisturbed.

Question 13: Do you agree with the costs and benefits of the options under consideration in relation to buy-to-let mortgages, as set out in the Impact Assessment?

We are not qualified to comment on the financial costs and benefits of the proposal as set out in the impact assessment. Although, with regard to compliance costs we note that it has been reported that the Association of Mortgage Intermediaries AMI director Robert Sinclair has said, whilst welcoming the regulation of the buy-to-let market that: *"...there should be no "significant additional costs" arising from the introduction of [such] new regulations."*

In relation to the non-monetary benefits of the proposal we would add that not only would the proposals help to ensure market stability but would have far-reaching positive affects on those outside of that market. In particular, if buy-to-let lending and borrowing is less likely to be inappropriate and unsustainable there is less likelihood of repossession which is good news for the tenants of the properties on which loans are secured.

We also draw your attention to the points we made in our answer to question 5 regarding the benefits to society as a whole and the public purse of greater consumer protection.

Question 14: Do you agree that FSA regulation of buy-to-let mortgages should be limited to lending to individuals and trustees?

The experience at Business Debtline backs up the assertion in the consultation paper that the majority of buy-to-let lending will be covered if lending is limited to individuals, sole traders and unincorporated partnerships. We therefore agree that it makes sense to mirror the first-charge residential lending exclusion of business-to-business lending from FSA regulation.

Question 15: Do you agree that the proposed new condition relating to the use of the property as a dwelling would include buy-to-let mortgages and continue to include residential mortgages?

We do not feel qualified to comment definitively upon how legally watertight the proposed new definition is. However from a lay, commonsense perspective, it would appear to make it clear that the intention is to include mortgages secured on property that is let to tenants (in addition to those already covered by the existing definition).

Question 16: Do you agree that the regulated activities in relation to regulated mortgage contracts should apply to buy-to-let mortgages?

We agree that the regulated activities in relation to regulated mortgage contracts should also apply to buy-to-let mortgages in future.

Question 17: Do you agree that the exemptions and exclusions that apply in relation to regulated mortgage contracts are appropriate for buy-to-let mortgages?

We do not feel qualified to respond to this question.

Question 18: Do you agree with the analysis of potential consumer detriment in the market for the onward sale of mortgage books?

We agree with the analysis that there is potential for significant consumer detriment from the onward sale of mortgage portfolios to unregulated firms who – unfettered by the FSA's regime - may seek to increase the profitability of such transactions by increasing interest rates and charges and not treating repossession as a last resort.

We would also like to add that we have anecdotal evidence that the potential for consumer detriment from onward sale does not only apply when the purchaser is unregulated. We are aware of cases where a regulated mortgage company has bought sub-prime mortgage books and adopts a more hard-line approach to arrears collection than to its own mortgage portfolio. This type of inconsistency manifests itself in:

- being less inclined to offer / agree to forbearance options;
- seeking the 'security' of a suspended possession order even when a good arrears payment offer was on the table; and
- commencing repossession action much more quickly than on comparable accounts in its own portfolio and seeking outright possession when this does not appear to be justifiable.

Question 19: Do you agree that borrowers should continue to benefit from the protection of FSA regulation in the case that their mortgage is sold on by their lender?

In view of the potential for consumer detriment following the selling on of a mortgage book we strongly agree that the acquisition of mortgage books should become a regulated activity to ensure that borrowers continue to benefit from the protection provided by FSA regulation and in particular the requirement to treat customers fairly.

In view of our comments in our answer to question 18 regarding the scope for inconsistency, even when the purchasing company is regulated, we would welcome a firm instruction to lenders that this type of activity is not treating customers fairly.

Question 20: Do you agree with the costs and benefits of the options under consideration in relation to protecting borrowers when mortgages are sold on, as set out in the Impact Assessment?

We are not qualified to comment on the financial costs and benefits of the proposal as set out in the impact assessment but we draw your attention to the points we made in our answer to question 5 regarding the benefits to society as a whole and the public purse of greater consumer protection.

Question 21: Do you agree that the proposed definition of “managing a regulated mortgage contract” would include the activities that have the potential to cause harm to borrowers when mortgages are sold on?

We do not feel qualified to comment definitively upon how legally watertight the proposed new definition is. However from a lay, commonsense perspective, it would appear to make it clear that the intention is to include those activities that have the potential to cause harm to borrowers when mortgages are sold on.

Question 22: Do you agree that a mortgage owner’s ability to delegate this activity to a third party means that only those firms engaging in activity with the potential to cause harm to borrowers will be subject to regulation?

We do not feel qualified to respond to this question.

Question 23: Do you consider that there will be further costs and benefits of the options under consideration when these options are combined, which are not reflected in the Impact Assessments?

We are not able to identify any further costs and benefits of the options under consideration at this stage.



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