



## Association of Mortgage Intermediaries response to FSA's CP10/16 Mortgage Market Review: responsible lending

16 November 2011

This response is submitted on behalf of the Association of Mortgage Intermediaries (AMI). AMI is the trade association representing over 75% of UK mortgage intermediaries.

Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product to meet the individual consumer's mortgage requirements. Our members also provide access to associated protection products.

Our members are authorised by the Financial Services Authority (FSA) to carry out mortgage and insurance mediation activities. Firms range from sole traders through to national firms and networks with thousands of advisers.

AMI welcomes the opportunity to respond to FSA's consultation paper on Mortgage Market Review: Responsible Lending. AMI previously responded to the consultation questions from this paper on interest-only mortgages in September.

We welcome that FSA continues to consult openly with industry on its thinking on responsible lending. However, the fragmented approach of breaking the various consultation papers and policy statements into subject issues has made it difficult to respond. Furthermore, this has restricted us from responding with a detailed analysis identifying the full impact of the proposals, their interrelationships and the consequent costs.

### Executive summary

- We believe that whilst the principles behind the free disposable income calculation may be reasonable, the application of the strict rules for the assessment, in particular when considering both consumers' committed and discretionary expenditure, would cause substantial detriment to consumers and the mortgage market.
- The parameters that are proposed for the maximum borrowing capacity are far too constrained. Clearly consumers should not be undertaking excessive borrowing that is beyond their means. However, decisions on lending should be based on individuals actual circumstances rather than an artificial cap being placed through a generalised borrowing structure.

- Those consumers intending to take out an interest-only mortgage should not be constrained by an assessment being made on a capital repayment basis. Assessments should be made based on an individual's actual circumstances.
- There is little justification of why a 25 year term has been applied as the default figure by which the maximum borrowing capacity should be calculated. Whilst consumers can take out a mortgage over a longer term, providing they can afford it over 25 years, such a restriction places a hurdle which some consumer would not be able to get over. This would limit those consumers for whom a longer term mortgage may be more appropriate for their needs.
- The existing 1% margin applied to the Key Facts Illustration (KFI) for future interest rate rises is easy for consumers to understand and allow the simplest way of assessing the impact of future interest rate changes. The more complex the system becomes the less likely consumers will be able to understand the effects of such increases, even if a more accurate system could be established. Ultimately if the objective is to create a system where the consumer is made aware of the effects of interest rate changes, then its simplicity should be paramount.
- It is questionable whether an artificial buffer for credit impaired borrowers is required on top of the additional FSA's proposals on affordability. Lenders should be pricing products appropriately according to risk, therefore, an adequate buffer should already be in place in this respect. It is not possible to remove all risk from the market and restricting borrowing by a given percentage will not stop life events causing consumers to suffer financial difficulties in the future. Furthermore, requiring that this buffer is applied on top of declared commitments could encourage non-disclosure from consumers and/or discriminate against those who do give a full declaration.
- Consumers receiving advice on their mortgage is still the most appropriate solution to ensuring that they obtain a product that is affordable and appropriate for their needs. We believe that advice should be the default route for all consumers. For some groups and products, such as first-time buyers and interest-only mortgages, advice should be compulsory, with a customer opt-out, which explains the loss of protection.
- There seems to be little evidence that credit scored approved loans have performed worse on mortgages in the prime sector than income verified loans. Lenders have already adapted their systems and procedures as risk appetites have changed. Banning all forms of fast-track is not an appropriate solution to those issues identified by FSA.
- The Consumer Credit Act 2006 (CCA06) provides a high-net worth exemption whereby those consumers who are considered capable of looking after themselves are able to opt-out of the protections afforded to them under the act. The MMR should address the issue of how high-net worth client exemptions are considered, given that this was thought to be relevant enough to become statute under the CCA06.

## Introduction

Throughout the consultation process for the MMR FSA has proposed a range of solutions over a range of consultation papers.

Whilst FSA's intention of ensuring that all borrowers can afford their borrowings is clearly something that AMI strongly supports, we believe that FSA needs to carefully consider the consequences of applying such a broad range of proposals to the mortgage market. We are concerned that the current proposals appear to apply virtually all remedies, with little

consideration of the cumulative impact on consumers' ability to borrow. It also potentially creates a series of mortgage and property prisoners. The cost to firms would be significant and this inevitably will be passed on to consumers.

A study by Policis found that if the draft rules were applied as outlined in FSA consultation paper, "A significant proportion of mortgagors (19%) could, potentially, be prevented from moving or re-mortgaging while yet more (31%) would have to borrow less than they require". (Policis – New approaches to mortgage regulation)

Furthermore it found the report stated that, "A forward looking analysis on the basis of mortgage holders who would want to move and renters who want to buy within a year suggests that 483,000 would be affected, with 150,000 shut out entirely and lending volumes for house purchase reduced by almost £42bn per year. A further 380,000 hoping to remortgage would be disappointed, cutting up to another £45bn per year from the market". (Policis – New approaches to mortgage regulation).

FSA should consider the total impact of all the draft rules on consumers and the mortgage market.

The proposed rule changes would make lenders ultimately accountable for affordability assessment. However, the decision to lend has always been for the lenders to make and the current MCOB rules basically confirm the same position. Therefore, it would seem that appropriate supervision of existing rules would have delivered an equal or better outcome, to that of rewriting the MCOB rules.

## Main issues

### Affordability assessments

FSA's proposals would enforce a rigid income and expenditure assessment regime on the mortgage market. However, this would give no consideration to consumer's actions after the mortgage has completed. Requiring that any assessment includes both committed and discretionary expenditure would be extremely inflexible for meeting consumers' needs.

Whilst a consideration of foreseeable changes is proposed, such an assessment would still only represent a snapshot in time. Greater flexibility would be required, such as taking into account that first-time buyers' or any consumer for that matter, may previously have had high levels of discretionary expenditure, when they had the disposable income to do so, which will reduce after they take out their mortgage due to their increased commitments and responsibilities.

### Free disposable income calculation

Income minus expenditure is a logical methodology for establishing an individual's disposable income at a set point in time. The principle behind the free disposable income calculation that FSA has proposed does not appear to represent anything new. However, what is concerning is the details in the draft rules on what is considered to be valid income and how expenditure is considered. FSA's draft rules on this area are too narrow and restrictive. In particular the rules around foreseeable changes and considering both committed and discretionary expenditure.

## Maximum borrowing capacity calculation

### Capital repayment

If the consumer is taking out an interest-only mortgage, and has no intention of taking out a capital repayment mortgage, then the assessment should be conducted on an interest-only basis. That is not to say that there should be a reduction in the requirement to ensure that the mortgage is affordable and suitable for the consumer, rather that such an assessment should be based on their actual requirements. The current proposals allow for the cost of the repayment plan to be removed from the assessment, so that these costs are not double counted under the capital repayment calculation. We believe that it would be more logical that if the consumer is already committed to holding a repayment plan that the assessment is undertaken on an interest-only basis. Of course there are other factors affecting the suitability of an interest only mortgage but these can be considered outside of a maximum borrowing calculation.

### 25 year term

FSA has not justified why the 25 year term has been used in the maximum borrowing capacity calculation. It appears that FSA has assumed that mortgage terms increase as consumers stretch their affordability and that over the long-term interest costs increase the overall cost of borrowing. However, there is little evidence that consumers suffer actual detriment due to this. There is no evidence that a mortgage greater or fewer than 25 years results in higher levels of arrears. Whilst the 25 year term may often be seen as the default term, it has only manifested itself due to the historic relationship between mortgages and endowment policies. As such, we do not consider that FSA should place a hurdle by which affordability would be constrained to this shorter term if the consumer intends to borrow over a term greater than 25 years. Furthermore, to do so ignores other factors such as the removal of fixed retirement dates, which means consumers can continue to work for longer if they wish. Also it is the norm in many EU countries to have a longer term mortgage. “The typical maturity of the loan is 20 to 30 years, but up to 40 years in Belgium, Ireland, Greece, Italy, Luxembourg and Malta, up to 50 years in France, Spain and Portugal and up to 60 years in Finland”. (AMI - The UK Mortgage Market – a comparative study reflecting US and European influences– August 2009)

### Future interest rate changes

In FSA’s discussion paper, to account for future interest rate changes, FSA considered using a simple 2% above base rate figure, rather than applying a more sophisticated system. The solution proposed by FSA now is to publish interest rates based on prevailing forward swap rates. However, forward swap rates can be volatile over the short-term and a single figure may not be appropriate across all mortgages, which could be linked to either LIBOR or BofE.

Under the current rules a 1% margin is applied to the interest rate in the KFI so that consumers are made aware of the effects of future interest rate rises. Using a 1% figure is easy for consumers to understand and allows a simple method for assessing the impact of future interest rate change. It allows consideration of not only what would happen in the event of a 1% increase but can simply be used to consider what the effects would be if this was doubled (2%) or tripled (3%). The more complex the system becomes the less likely consumers would be able to understand the effects of such increase, even if a more accurate system could be established. Ultimately if the objective is to create a system where the consumer is made aware of the potential effects of interest rate changes, then its simplicity should be paramount.

We do not believe that an additional marginal interest rate should be applied to the calculation if the consumer is taking out a lifetime fixed rate mortgage as there would be no revert to rate.

### Credit impaired buffer

Those consumers who are considered to be credit impaired by lenders are already subject to a variety of buffers when it comes to obtaining a mortgage. Primarily a lender should be pricing its products appropriately according to risk. If this is done correctly, it is questionable whether a further category of buffer is required.

FSA should also consider whether an additional buffer is required to supplement its other proposals. For example, a robust assessment of a consumer's free disposable income could by itself be sufficient without the need for an additional buffer being applied.

If a buffer figure is to be applied to any calculation then further consideration needs to be given as to what it is intending to achieve. Applying a buffer to the free disposable income calculation by subtracting 20% may only be an appropriate solution if credit impaired consumers could become 20% unemployed, 20% sick, or 20% divorced/separated.

Policis report found that, "the main drivers of stress and mortgage payment problems are job loss and reduced earnings and not mortgage affordability. Of the 5% most stressed and struggling currently over half (51%) have lost their jobs, with most of the remainder having reduced working hours (13%) or reduced income from bonuses or commissions (11%) or self-employment (13%)". (Policis – New approaches to mortgage market regulation).

FSA's proposal should take account of changing life events as factors affecting levels of arrears, rather than relying on proposals based on front-end measures to restrict levels of borrowing.

An appropriate solution would also be for lenders to ensure that products designed to be offered to those who are credit impaired are appropriately priced and protected. This would apply a natural buffer through the interest rate, whilst ensuring the firm is appropriately remunerated for the risk they undertake.

We are concerned that limiting the credit impaired borrowing through a buffer could have seriously unintended consequences. Credit impaired consumers who are informed that the amount they can borrow through a mortgage would be reduced by 20% could obtain additional borrowing through alternative sources, once the mortgage has completed. These proposals could simply force credit impaired consumers towards more expensive unsecured loans or unregulated credit.

The proposed buffer could result in these consumers effectively coming out of the process with a mortgage and unsecured credit combination, as a means of them meeting their borrowing needs. This is not a better outcome for this group of consumers.

### High-net worth exemptions

The CCA60 provides the possibility of an exemption for high-net worth consumers who consider themselves to be capable of looking after themselves. We believe that the MMR should address the issue of those consumers who are/or could be considered as high-net worth. Whilst FSA has proposed the idea of individual firms applying for waivers if they deal with high-net worth clients, this would be addressing the situation from the wrong perspective. It should not be for the firm to decide that they should be exempt, rather it should be for those high-net worth clients to opt to become exempt.

Under the CCA06 where the borrower is a natural person of high-net worth the regulations under the Act will not apply. "High-net worth" individuals are defined as persons whose income after tax and national insurance is not less than £150,000 per year or as persons who have net assets of no less than £500,000 excluding their primary residence, any redundancy payments or any pension or other retirement benefit payments.

In order for an agreement to fall within this high-net worth exemption, the agreement must include a declaration made by the borrower that they agree to forgo the protection and remedies that would otherwise be available to them if the agreement were to be a regulated agreement.

Any such declaration must be accompanied by a statement of high-net worth. This statement must be provided by a qualified person such as an accountant (who must be a member of a relevant chartered body) or, in the case of income only, an employer. A borrower is not permitted to provide their own statement.

Given that such exemptions exist under statute we believe that FSA should consider how they could be applied to the MMR. To ignore such an issue is likely to see consumers opting for a combination of a small first charge mortgage followed by a larger second charge loan in order to take advantage of such exemptions for their borrowing requirements.

#### Income verification

It has been FSA's intention from the discussion paper (DP) to remove non-verified income mortgages from the mortgage market. Self-certification mortgages will no longer be possible as all income must be verified. However, the market has already adjusted itself. Whilst some lenders have already removed their self-certification products from the market, many other self-certification products have disappeared as the lender itself is no longer active in the market. FSA needs to take account of these changes within its proposals.

The proposals would also see fast-track mortgages only being allowed where the income has been verified. However, research from Fitch Ratings showed that fast-track mortgages in the prime sector did not appear generically more risky (in terms of arrears) than income verified loans. When conducting its own research FSA found that fast-track mortgages had a lower rate of arrears and possessions than either self-certification mortgages or income verified mortgages, although fast-tracking did not perform equally well across all lenders. For some smaller lenders, performance was generally worse.

Given that the market has now reduced to a small number of large lenders it would seem that those smaller lenders, which had poorer performing fast-track mortgages, would in all likelihood have left the market already.

FSA could conduct this research through its PSD and arrears dataset to establish the performance of the remaining larger lenders in the market place. It could then consider whether its solutions should focus on restricting fast-track products or stopping those lenders with business models that would be more likely to result in a poorer performing fast-track mortgage books from re-entering the market.

If FSA is concerned about firms returning to the market in the future then this is either an authorisation issue for those who have left the market completely (and also for new entrants), or a system and controls issue for those lenders that had poor performing fast-track records, which FSA should now be able to identify.

It would appear that the issues identified with fast-track are regulatory systems and controls failings for some lenders, rather than a failing of fast-track as whole. Banning all forms of fast-

track is not an appropriate solution to the issue identified and will lead to substantial additional costs to the industry, which will inevitably be passed on to consumers.

### Product regulation

FSA's research did not find sufficient evidence that high LTI or DTI ratios, or equity release lending, led directly to higher levels of arrears and possessions. Whilst high LTV (>80%) was found to be an indicator of the likelihood of a consumer falling into impairment, FSA acknowledge that other factors influenced these findings and the issues around LTV were more complex than considering the ratio in isolation. We would expect to see robust evidence, cost benefit analysis and market failure analysis before any form of product regulation is proposed. We have not seen such justification to date.

### Social implications

We are concerned about the overall impact of these proposals on consumers' ability to obtain a mortgage and, therefore, become or remain owner occupiers.

A YouGov survey found that "85% of the population aspired to home ownership as their most preferred form of tenure, with very similar results across age ranges and regions, and with relatively little difference between socio-economic groups with 89% of ABC1s and 79% of C2DEs citing home ownership as their most preferred tenure". (YouGov for CML 2056 nationally representative sample of UK adults, undertaken September 2010)

FSA's original impact analysis showed that the proposals would have led to 17% of borrowers who took out mortgages between 2005 and 2009 being unable to obtain their mortgage, had the proposed requirements been in place at the time.

However, further analysis from CML found that FSA's data had not applied all of the elements from its draft proposals. Once this was applied CML found that applying the maximum borrowing capacity, a 2% interest rate stress test and credit imparted buffer would have increased this figure to 51% (CML - An evidence-based review of MMR proposals on responsible lending)

The question has to be asked that if this many consumers are excluded from obtaining the mortgage they require, what are they expected to do in the long-term? Whilst some may opt for reduced levels of borrowing many others already struggling to get on the property ladder will be resigned to renting long-term.

Policis report found that only 7% of private renters and 13% of those in social housing see renting as a preferred life-style and tenure choice in the long-term. 50% of private renters and 36% of social housing tenants viewed renting as a good option "for now" but plan to buy one day. 78% of those in private rented accommodation and 51% of social housing tenants aspire to own their own home. (Policis – New approaches to mortgage market regulation)

Clearly homeownership is still seen as aspirational by the majority of those in rented accommodation. Furthermore, this does not even consider those potential first-time buyers currently living with parents. If FSA's proposal will reduce the ability of these consumers to obtain their goals, then a wider political debate must be held. It should not be for FSA to impose such changes on UK society without a full political debate being undertaken.

## Responsible borrowing

Consumers should be aware of their responsibilities in the borrowing process, both in terms of the decisions they make and their responsibility to provide accurate information to lenders and intermediaries. However, whether increasing consumer awareness of these issues, and then changing their behaviour, can be achieved through CFEB is unproven.

## Implementation

We believe that it is essential that when it comes to the implementation of any changes FSA does this at a time that would have the least adverse effect on the mortgage market.

Whilst the implementation dates have not yet been set, doing so whilst the mortgage market is still in a delicate position, as opposed to waiting until a healthier situation exists, could have extreme adverse consequence.

We believe that FSA should wait to receive responses to this consultation and the distribution and disclosure paper then produce a further combined consultation, before setting any final rules. This would allow stakeholders to see, and comment on how FSA envisages the mortgage market operating once its proposals are implemented. This will also allow for a complete set of draft rules to be consulted on prior to their implementation.

Give the potential cumulative impact of the proposal and the segregated manner in which FSA has consulted on each section, we believe that a consultation on the full set of draft rules is essential before they are implemented.

## Consultation questions

### Q1: Do you agree with our proposals for income verification?

The proposed rule changes will make lenders ultimately accountable for affordability assessments. However, the current MCOB rules basically confirm the same position.

The decision to lend has always ultimately been for the lender to make. There has been little evidence that the current MCOB rules were perceived to be too complex, convoluted or misleading. Therefore, it does not appear that the proposed new rules have been re-written due to a perceived lack of understanding. What does appear to be the case is that there was a lack of supervision of the current rules by FSA. As such, appropriate supervision of the existing MCOB rules would have delivered an equal or better outcome than re-writing the MCOB rule book will.

### Q2: Do you agree with our approach to assessing income?

Under FSA's proposals self-certification mortgages will no longer be possible as all income must be verified. It has been FSA's intention from the DP to remove non-verified income mortgages from the mortgage market. However, we have seen that the market has already adjusted itself. Whilst some lenders have already removed their self-certification products from the market, many further self-certification products have disappeared as a result of the lender itself no longer being active in the market. FSA should take account of the actions already taken by lenders in the mortgage market.

The proposals will also see fast-track mortgages only being allowed where the income has been verified. However, research from Fitch Ratings showed that fast-track mortgages in the prime sector did not appear generically more risky (in terms of arrears) than income verified loans. When conducting its own research FSA found that fast-track mortgages have a lower rate of arrears and possessions than either self-certification mortgages or income verified mortgages, although fast-tracking did not perform equally well across all lenders. For some smaller lenders, performance was generally worse. FSA has acknowledged this but it has not altered its policy position in the CP.

Given that the market has now reduced to effectively a few large lenders, it would seem that those smaller lenders, which had poorer performing fast-track mortgages, would in all likelihood have left the market already.

FSA should conduct research through its PSD and arrears dataset to establish the performance of the remaining large lenders in the market place. FSA could then consider whether its solutions should focus on restricting fast-track products or stopping those lenders with business models that would be more likely to result in a poorer performing fast-track book from re-entering the market.

If FSA is concerned about firms returning to the market in the future then this is either an authorisation issue for those who have left the market completely (and also for those new entrants), or a system and controls issue for those mothballed lenders that had poor performing fast-track records, which FSA should now be able to identify.

Therefore, it would appear that the issues identified with fast-track are regulatory systems and controls failings for some lenders, rather than a failing of fast-track as whole. Banning all forms of fast-track is not an appropriate solution to the issue identified.

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

The proposed guidance in the draft rules gives examples of expenditure to consider. FSA points to the fact that the items shown in the guidance are not exhaustive. However, if when considering expenditure lenders should be going so far as considering food and drink, footwear, recreation and holiday costs, it is hard to see what could be left to consider as part of the assessment which could be material.

This rigid assessment of expenditure requires both committed and discretionary expenditure to be accounted for. However, the enforcement of a rigid income and expenditure assessment regime gives no consideration to consumers' actions after the mortgage has completed.

Consumers who may have high discretionary expenditure could reduce this expenditure once their mortgage completes. The current proposals do not take into account consumers' willingness to prioritise their expenditure when required to do so.

Any rules around calculating affordability should include an assessment of committed expenditure but should exclude discretionary expenditure from the calculation.

FSA needs to consider the reason for arrears occurring. It is not possible to design a system that will mitigate all risk by considering a consumers circumstances, and possible future circumstances, at a given point in time.

## BSA - Factors causing mortgage arrears

Loss of job/income	43%
Increased monthly repayment amount	16%
Other essential/ unplanned expenditure	16%
Ill health	15%
Paid other debt instead	14%
Divorce/ Separation	8%
Decided to spend on other items	7%
Forgot	5%

\*Respondents could choose more than one response, so percentages add to more than 100%

(BSA - Understanding Mortgage Arrears -

[http://www.bsa.org.uk/docs/publications/understanding\\_mortgage\\_arrears.pdf](http://www.bsa.org.uk/docs/publications/understanding_mortgage_arrears.pdf) )

The BSA study shows that it is not over borrowing or indebtedness that causes problems. It is life events, such as loss of job which are the main cause of payment difficulties.

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

We do not believe that lenders should be required to do this. This could cause significant increase in the already costly process of purchasing a property.

The average solicitor costs for buying and selling a property are substantial:

- £1,060 - Average cost of conveyancing - the legal transfer of ownership of a property - for a buyer (source: DETR)
- £570 Average cost of conveyancing for a house seller, (source: Woolwich's annual Cost of Moving survey)

Whilst the solicitor's cost associated with remortgaging a property may be less, this is in part due to lenders offering a streamlined remortgage conveyance service. Such a process does not account for acting to repay credit commitments on the transaction, therefore, the costs of remortgaging would be likely to increase.

Furthermore such proposals will further remove the borrowers own responsibility within the agreement for ensuring that they can repay their credit commitments, as agreed with the lender.

Creating a system that requires the lender to ensure that these credit commitments are repaid would not place any restriction on additional credit commitments being obtained after the mortgage has completed. Therefore, this would create a costly and timely exercise that would not guarantee that the consumer would not become over indebted once the mortgage has completed. This could only be achieved through the removal of credit facilities, which would be unworkable.

FSA should acknowledge that, as it does not regulate all forms for credit, it cannot apply measures that will ensure that borrowers will not become indebted through, for example, further unsecured borrowing once the mortgage has completed.

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

The principle behind the free disposable income calculation does not represent anything new or unreasonable. Many lenders already adopt similar models when undertaking their lending decisions. Income minus expenditure is a logical methodology for establishing an individual's disposable income at a set point in time.

However, the way in which the principles of assessing free disposable income are presented in the draft rules and guidance is of much greater concern.

It is questionable how 'foreseeable at any time during the term of the regulated mortgage' could ever be applied in practice.

The OFT considered this problem as part of its consultation on its irresponsible lending guidance document. OFT stated that:

"The Guidance makes clear that the OFT would regard 'reasonably foreseeable' in this context as a future event that may impact on the borrower's ability to make repayments on a credit agreement in a sustainable manner which the borrower knows will occur and of which the creditor is, or should be, aware".

(OFT - Summary of responses to the consultation on 'Irresponsible Lending – OFT guidance for creditors' August 2010)

The example given by OFT is that of a borrower, approaching retirement, who knows that his disposable income will fall when he retires. However, even this example has now become clouded as the issue of retirement has been obscured by the government proposals to remove fixed retirement dates.

What is clear is that OFT acknowledged that only events that are known to occur should be considered as foreseeable. It could be argued that FSA may view mortgage lending as requiring more stringent requirements. However, as the lending is usually over a longer period than the products captured under OFT's guidance, this would make it even more difficult to make assumptions about future events being known and/or foreseeable.

Changes to both committed and discretionary expenditure can be made by consumers. However, the proposals only seem to consider these from a negative perspective, rather than the prospect of the consumers reducing their expenditure.

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

If the consumer has no intention of taking out a capital and interest mortgage, then after an assessment of their suitability for taking out an interest-only mortgage, the borrowing should be assessed on the basis of the product they are taking out.

That is not to say that there should be a reduction in the requirement to ensure that the mortgage is affordable and suitable to them, rather that such an assessment should be based on their actual requirements. The current proposals allow for the cost of the repayment plan to be removed from the calculation, so that these costs are not double counted under the capital repayment calculation. We believe that it would be more logical that if the consumer is already committed to holding a repayment plan than the assessment is undertaken on an interest-only basis.

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

FSA has not presented any statistical data as to why the 25 year term has been used in the maximum borrowing calculation. There is no evidence that a mortgage greater or fewer than 25 years results in higher levels of arrears. We accept that those mortgages exceeding a 25 year term will cost more in the long- term than those which do not, but this argument could be made when comparing any two terms.

It would appear that FSA has used the 25 year term as it has simple assumed that a 25 year term is the standard term that a mortgage should be. Whilst the 25 years term may often be seen as the default term this has only manifested itself due to the historic relationship between mortgages and endowment policies.

FSA's of moneymadeclear website acknowledges this assumption by stating "People often assume that the 'standard' mortgage term is 25 years, but you can choose a different term if it suits you and the lender agrees".  
(<http://www.moneymadeclear.org.uk/tables/bespoke/Mortgages>)

As such, we do not consider that FSA should place a hurdle by which affordability will be constrained to this shorter term if the consumer intends to borrow over a term greater than 25 years. Furthermore, to do so ignores the removal of fixed retirement dates, which means consumers can continue to work for longer if they wish.

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?

Since the DP was published FSA has moved away from considering using a simple 2% above Bank of England (BoE) base rate figure to applying a more sophisticated system.

The solution proposed by FSA is to publish interest rates based on prevailing forward swap rates. However, forward swap rates can be volatile over the shorter-term and a single figure may not be appropriate across all mortgages, as they could be linked to either LIBOR or BoE base rate.

The current 1% margin is easy for consumers to understand and allows the most simplistic way of considering changes interest rates. A more complex system could reduce consumers understanding of the effects of such increase, even if a more accurate system could be established. Ultimately if the objective is to create a system where the consumer is made aware of how potential increases will affect them, the simpler this information can be presented the better.

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?

Those who are credit impaired will already be subject to a variety of buffers when it comes to borrowing funds. It is questionable whether a further buffer is required. Furthermore, FSA should consider whether this buffer is required in addition to the cumulative effects of FSA's proposals. For example, would the application of a robust affordability assessment alone be sufficient without the need for an additional buffer being applied.

After all, those within FSA definition who have, “within the last two years has been overdue, in an amount equivalent to three months’ payments, on a mortgage or other loan (whether secured or unsecured), except where the amount overdue reached that level because of late payment caused by errors by a bank or other third party” would have already had this commitment included within their affordability calculation. As such, under FSA proposed new rules they would have already had their borrowing capacity reduced by holding this commitment and being on a higher rate due to being deemed as credit impaired by the lender.

If a buffer figure is to be applied to any calculation then further consideration needs to be taken as to what they are intending to achieve. Applying a 20% buffer to the free disposable income calculation would be an appropriate solution if credit impaired consumers could become 20% unemployed, 20% sick, or 20% divorced/separated. As the BSA - Understanding Mortgage Arrears study showed, life events are more often the cause of arrears over other reasons such as over expenditure at the outset.

Therefore, if a buffer is to be applied a more appropriate method of calculating it should be considered and FSA must take account of life events in any calculation. It is simple not possible to mitigate all risk of a credit impaired borrower, or any borrower for that matter, from being unable to repay the mortgage at a later date.

What would be a more appropriate solution would be to ensure that products designed to be offered to those who are credit impaired are appropriately priced by lenders. This would apply a natural buffer through the interest rate, whilst ensuring that the lender offering the product is appropriate remunerated for the risk they undertake.

Limiting the credit impaired borrowing through an artificial buffer could have seriously unintended consequences. Credit impaired consumers who are informed that the amount they can borrow through their mortgage will effectively be reduced by 20% due to their circumstances will be able to obtain this extra 20% through alternative sources once the mortgage has completed. Therefore such proposals could simply force these consumers towards at best an unsecured loan or at worst unregulated credit. The proposed buffer could result in a these consumer effectively coming out of the process with a ‘together’ style mortgage and unsecured credit combination as the solution to meet their borrowing needs.

In addition, the definition of credit impaired, set out in the draft rules, does not make allowances for adverse credit data related to disputes over quality of goods.

#### [Q10: Do you agree with our approach to lending into retirement?](#)

Verifying a consumer’s income into retirement would be extremely difficult in reality. If the consumer is retired, or at retirement, a responsible estimate could perhaps be established. However, the further a consumer is from retirement the more variable their potential income becomes.

Policis’ study examines the effects of the proposed affordability test by age. It found that for those over 50 years old 35% could be refused any borrowing and 30% would not be able to borrow the amount they require. (Policis – New approaches to mortgage regulation).

FSA proposals are based on the consumer knowing when they are to retire. They give no consideration to the removal of fix retirement dates and the impact this has on the draft rules. With no fixed retirement date being in place in the future a clearer definition of what lending to retirement means would be required.

Q11: Are there specific typical 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?

As stated above we believe FSA should consider the high-net worth exemptions available under CCA06.

Q12: Do you agree with this approach to lifetime mortgages?

FSA's proposals would effectively make it far easier for a consumer in retirement to obtain a lifetime mortgage than it would be to obtain an interest-only mortgage. We are not convinced that this is FSA desired outcome. If it is, we would seek clarification as to why FSA would want to make it easier for consumers to obtain a mortgage where the interest is rolled up, as opposed to where the interest is paid throughout the term.

Q13: Do you agree with this approach to ensuring affordability for home purchase plans?

We believe that this should be left for individual lenders to decide upon.

Q14: In addition to the questions above, do you have any other comments on our approach to responsible lending? Do you have any comments on the draft rules as set out in [Appendix 1 Part 1]?

We have an overall concern about the standard of the draft rules. We are concerned not just about what the intended policy position is but also, and perhaps more fundamentally, about how these rules could later be read by an FSA supervisor.

We consider that these draft rules require urgent redrafting so that they are less ambiguous and more adaptable for lenders to use. We have committed below on the draft rules that we have particular concerns about:

Credit impaired customer

A customer who:

- (1) within the last two years has been overdue, in an amount equivalent to three months' payments, on a mortgage or other loan (whether secured or unsecured), except where the amount overdue reached that level because of late payment caused by errors by a bank or other third party; or
- (2) has been the subject of one or more county court judgments, with a total value greater than £500, within the last three years; or
- (3) has been subject to a creditors' individual voluntary arrangement or bankruptcy order which was in force at any time within the last three years.

Setting definitions of this type could result in lenders being forced to change their own definitions or criteria. Consumers who were not considered to be credit impaired by some lenders may now fall into this category.

## Amendments to the Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB)

### 11.3 Affordable borrowing and home financing

11.3.1 R A firm must not enter into, or make a further advance on, a regulated mortgage contract or home purchase plan unless it has assessed the regulated mortgage contract or home purchase plan (or the further advance) as being **affordable** for the customer. Income verification

11.3.2 R For the purposes of assessing the affordability of a regulated mortgage contract or home purchase plan (or further advance), a firm must **verify** a customer's current income, (and, if future income is relied on for affordability purposes, known future income) from **evidence independent of the customer**. The evidence used by a firm must be sufficient to allow the firm properly to assess affordability for that customer. A declaration by the customer or his representative of the affordability of the proposed regulated mortgage contract or home purchase plan is not sufficient for these purposes.

The intention of this rule may be to remove self-certification but the wording implies that accountants will have to be employed to verify any evidence of income that the consumer provides.

11.3.3 G Whether the available evidence is sufficient for the purposes of verifying a customer's income will depend on the individual circumstances of the customer, and will vary according to **such factors as the nature of the customer's employment and length of service in a profession**.

Length of service in a profession does not correlate directly to the security of that position. Long service could mean that a consumer is looking to move jobs shortly. Likewise the current cuts in the public sector would make all jobs in these sectors appears less secure than previously expected. Creating strict rules and guidance to make judgements on such criteria would appear unworkable.

11.3.4 G (1) For the purposes of the verification of a customer's income:

(a) a firm may use information it already holds about a customer's current income; for example, where the customer holds a current account with the firm; and

(b) a firm may use information provided to it by a home finance intermediary, but the mortgage lender or home purchase provider will retain responsibility for its **verification**.

11.3.6 R For the purposes of assessing affordability (see MCOB 11.3.1R) a firm must:

(1) **consider the expenditure to which the customer is committed**;

(2) consider the **customer's likely personal expenditure** (including for all dependents of the customer); and

(3) consider whether an allowance should be made for missed or understated expenditure of the customer.

- 11.3.7 G
- (1) Examples of expenditure to which a customer is committed for the purposes of MCOB 11.3.6R(1) include: servicing of secured and unsecured debt; income tax; national insurance; utility bills; council tax; shared ownership rent; insurance premiums; maintenance payments; school and university fees. This list is not exhaustive.
- (2) Examples of a customer's personal expenditure for the purposes of MCOB 11.3.6R(2) include: food and drink; clothing and footwear; health and personal care; transport; recreation; holidays. This list is not exhaustive.

This list is very restrictive. Including recreation and holidays does not leave room to consider how a consumer is likely to flex their spending once they have taken out their mortgage. First-time buyers, for example, would seem likely to have high levels of discretionary expenditure prior to taking out a mortgage but such expenditure is unlikely continue once they take out their mortgage. The rules need to consider the way in which consumers can prioritise and change their discretionary expenditure.

11.3.9 G A firm should have procedures in place for identifying any significant respects in which a customer's specific characteristics make the use of any aggregated or statistical data (see MCOB 11.3.8R(2)) inappropriate for that customer.

11.3.10 R Where a customer states an intention to repay prior borrowings(whether on a secured or unsecured basis) out of the sums advanced under a proposed regulated mortgage contract or home purchase plan (not including a further advance) a firm must ensure that those borrowings are repaid.

See response to question 4.

11.3.11 G A firm may ensure borrowings are repaid as referred to in MCOB 11.3.10R by making the payment direct to the debtor(s) as a condition of granting the regulated mortgage contract or home purchase plan.

11.3.12 R (1) For the purposes of this rule, the customer's free disposable income is the amount (if any) remaining when the customer's expenditure has been deducted from the customer's income. A regulated mortgage contract or home purchase plan is not affordable for a customer (see MCOB 11.3.1 R) if it is foreseeable that, at any time during the term of the regulated mortgage contract or home purchase plan, the payments to be made under it by the customer for a particular month (or other agreed payment interval) will be equal to or more than the customer's free disposable income over the same interval.

- (2) In assessing a customer's free disposable income over the term of a regulated mortgage contract or home purchase plan, a firm must:
- (a) take into account any information it has about the variability of the customer's income over time;

- (b) take into account any known or foreseeable future changes to income and expenditure, including (but not limited to) the effects of retirement on the income of the customer, where the term of the regulated mortgage contract or home purchase plan will extend into the customer's retirement; and
- (c) where a customer indicates an intention to work beyond the age at which that customer may reasonably be expected to retire during the term of the regulated mortgage contract or home purchase plan, consider both whether it is reasonably plausible that the customer has that intention and whether, in the particular circumstances of the customer, the intention is reasonably capable of being realised.

The term foreseeable is open to interpretation. OFT has acknowledged the difficulties in undertaking such an assessment on this basis in its work on irresponsible lending. See answer to question 5.

11.3.13 G A customer's free disposable income is the upper limit of what the customer can afford to repay (or pay) each month (or other agreed payment interval) towards a regulated mortgage contract or home purchase plan.

Requiring a consideration of what is affordable each month ignores the fluctuating nature of income for those who are self-employed, draw dividends from their business or receive any irregular income. These consumers may be perfectly capable of managing their money to make each month's payment but their circumstances would fail the criteria presented. Consideration needs to be given to those consumers who do not receive a set monthly income.

11.3.19 R (1) A mortgage lender must make an adequate record of the steps it takes to comply with the rules in MCOB 11.3.1R to MCOB 11.3.16R in relation to each customer.

(2) A mortgage lender must retain the record required by (1) for one year from the date at which the regulated mortgage contract is entered into or the further advance is provided.

It would seem that 11.3.19 (2) does not cover a sufficient length of time. It is generally accepted that documentation should be kept for at least six years. Given the role of FOS and its consideration of cases, encouraging business to only hold records for one year does not seem sufficient.

[Q15: Do you think our income verification proposals will impact any groups with protected characteristics \(e.g. race, religion\)?](#)

The Equality Act 2010 categorises 'age' as a protected characteristic. The impact of FSA proposals, in particular around the assessments of affordability and lending into retirement, would have a substantial impact on those consumers who are over 50. These issues should be considered in greater detail to ensure that there is no direct or indirect discrimination under FSA's rules.

Q16: How prescriptive should we be in defining a valid repayment method?

See AMI's response to FSA's consultation paper 10/16 MMR Responsible Lending – interest-only, which was submitted on 30<sup>th</sup> September.

Q17: Should lenders be required to check that there is a valid repayment method in place at the start of the mortgage, and then periodically through the term of the mortgage? How do you think this should work? How often should lenders check on the repayment method?

See AMI's response to FSA's consultation paper 10/16 MMR Responsible Lending – interest-only, which was submitted on 30<sup>th</sup> September.

Q18: Do you think there should be further controls on repayment methods? For example, how should 'sale of property' be controlled to prevent it being used where it is not a realistic option? If a minimum LTV, amount of equity or income level was set, where and how should this be done?

See AMI's response to FSA's consultation paper 10/16 MMR Responsible Lending – interest-only, which was submitted on 30<sup>th</sup> September.

Q19: Do you agree that these customer types benefit from interest-only mortgages? Are there any other customer types that might benefit from interest-only?

See AMI's response to FSA's consultation paper 10/16 MMR Responsible Lending – interest-only, which was submitted on 30<sup>th</sup> September.

Q20: Do you agree that some form of interest-only product without need for a repayment vehicle may be appropriate on a temporary basis for first-time buyers? If so, how should this be achieved? Would there be any specific impact on older consumers?

See AMI's response to FSA's consultation paper 10/16 MMR Responsible Lending – interest-only, which was submitted on 30<sup>th</sup> September.

Q21: Do you agree that there are some limited circumstances where assessing affordability on an interest-only basis may be appropriate? If so, when? And should any additional controls be applied to prevent this being gamed on affordability grounds?

See AMI's response to FSA's consultation paper 10/16 MMR Responsible Lending – interest-only, which was submitted on 30<sup>th</sup> September.

Q22: Do you think that any changes to our interest-only requirements will impact any groups with protected characteristics (e.g. race, religion)?

See AMI's response to FSA's consultation paper 10/16 MMR Responsible Lending – interest-only, which was submitted on 30<sup>th</sup> September.

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

We do not believe that further product regulation should be applied to the equity release market. Our concerns about the affordability assessment are stated in the relevant sections of this response.

Q24: Do you have any comments not made previously in response to DP09/3 on the case for not banning loans above defined LTI, LTV or DTI ratios?

It is for FSA to conduct an appropriate cost benefit analysis and market failure analysis to justify policy changes. We have not seen sufficient justification for such product regulation.

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)?

FSA research did not find sufficient evidence that high LTI or DTI ratios, or equity release lending, led directly to higher levels of arrears and possessions. Whilst high LTV (>80%) was found to be an indicator of the likelihood of a consumer falling into impairment, FSA acknowledged that other factors influenced these findings and that the issues around LTV were complex. We would expect to see robust evidence if further product regulation was to be proposed by FSA. We have not seen such justification for it to date.

Q26: Do you have any comments on the above clarifications to MCOB 12.4.1 R or the draft Instrument in Appendix 1 Part 2 that gives effect to them?

No comment as this is an issue best left to lenders to comment on.

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

No comment

Q28: Do you have any additional comments on the sections of the draft Instrument that limit the number of times missed payment fees should be charged?

No comment

Q29: How much time (if any) would your firm require to comply with the proposed changes to MCOB 13.3 around limiting missed payment fees?

No comment

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?

No comment

Q31: Do you have any additional comments on the draft Instrument that gives effect to this?

No comment

Q32: How much time (if any) would your firm require to comply with the proposed widening of MCOB 12.4 and MCOB 13.3 to payment shortfalls (noting that the record-keeping requirements in 13.3.9 R now apply to payment shortfalls)?

No comment

Q33: Do you have any comments on this suggested regime?

No comment

Q34: Do you have any comments on the macro-prudential considerations set out above?

No comment

Q35: Do you have any comments on the cost-benefit analysis for our proposals on responsible lending & arrears charges?

No comment

Q36: Do you have any comments on the high-level cost benefit analysis on our current position on interest only mortgages and non-banks?

No comment

Q37: Do you have any comments on the compatibility statement?

No comment