

Shelter's response to the HM Treasury

consultation –

Mortgage regulation: a consultation

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Shelter

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

- A national network of over 20 advice centres
- Shelter's free advice helpline which runs from 8am-8pm
- Shelter's website which provides advice online
- The Government-funded National Homelessness Advice Service, which provides specialist housing advice, training, consultancy, referral and information to other voluntary agencies, such as Citizens Advice Bureaux and members of Advice UK, which are approached by people seeking housing advice
- A number of specialist services promoting innovative solutions to particular homelessness and housing problems. These include Housing Support Services which work with formerly homeless families, and the Shelter Inclusion Project, which works with families, couples and single people who are alleged to have been involved in anti-social behaviour. The aim of these services is to sustain tenancies and ensure people live successfully in the community
- We also campaign for new laws and policies - as well as more investment - to improve the lives of homeless and badly housed people, now and in the future
- Our services have seen a large increase in queries from clients in mortgage arrears over the last two years:
 - Since February 2009, our advice web pages on repossession have had over 125,000 page views
 - Our dedicated homeowner helpline staff take around 300 calls relating to arrears and repossession every month
 - There is high demand for mortgage possession advice across all face to face and Helpline services. We also give advice to anyone facing mortgage repossession at court as part of the Housing Possession Court Duty scheme
 - We have actively lobbied for greater regulatory intervention in the mortgage market since the beginning of the economic downturn and undertaken primary research to monitor trends in arrears and repossessions

Summary

Shelter strongly supports the proposal to extend the scope of Financial Services Authority (FSA) regulation to include buy-to-let lending, second-charge lending and onward sale of mortgage books.

Chapter 2: Regulation of second-charge mortgages

Q1: Do you agree with the analysis of the second-charge mortgage market?

We agree with this analysis. In addition, our research has suggested some inconsistency across second-charge lenders' arrears management practices:

- National Debtline callers with mortgage or secured loan arrears were surveyed about how their lender(s) had responded to the situation. Only 34% of those in arrears with their secured loan were satisfied with the way they were treated by their lender compared to 57% of those in arrears with their mortgage.¹
- One court duty desk adviser surveyed commented that *"Secured loans, with sub prime lenders, are the most problematic... They are the prime reason for my attendance at court"*²

As data on second-charge repossessions is only available from Finance & Leasing Association (FLA) members, there is some confusion as to the extent of second-charge arrears and repossessions as compared to market share. Further evidence includes:

- In a sample of 452 possession cases in English county courts, 16% of cases were being brought by second-charge lenders. This appears to be disproportionate to the market share of second-charge lenders.³
- Analysis of 90 Shelter case files showed that in eight cases, possession action was being taken by a second-charge lender. In a further nine cases, borrowers were facing action from both the first and the second-charge lender.⁴

¹ *Mortgage and secured loan arrears: Adviser and borrower surveys*, AdviceUK, Citizens Advice, Money Advice Trust, Shelter, April 2009

² Ibid.

³ *Turning the tide? Evidence from the free advice sector on mortgage and secured loan possession actions in England in July 2009*, AdviceUK, Citizens Advice, Shelter, December 2009

⁴ Ford, J, & Wallace, A., *Uncharted Territory? Managing mortgage arrears and possessions*, Shelter, July 2009

We recommend that the FSA and Ministry of Justice (MoJ) collect data on type of loan as part of their arrears and repossessions recording. This data would inform development of appropriate regulatory frameworks. The current, patchy data set makes it difficult to have a clear picture of consumer detriment, particularly when new financial products and trends emerge.

Q2: Do you agree that extending the scope of FSA mortgage regulation to include the second-charge mortgage market would support the Government's objective of ensuring a fair, stable and efficient market for second-charge mortgages?

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

- At present, the Office of Fair Trading (OFT) and FSA both seek to regulate the same sorts of issues in slightly different ways. Both existing regulatory systems have different strengths and weaknesses. This can mean a lack of clarity and consistency of practice across the mortgage market, and confusion for consumers.
- Regulating both markets should improve the FSA's ability to oversee wider financial risks.
- We fully support proposals to reform mortgage lending rules as outlined in the recent FSA Mortgage Market Review.⁵ Introducing tougher FSA regulation in the first-charge residential market would make little sense if the second-charge market – and indeed the buy-to-let market - did not adhere to the same standards.
- One regulator would ultimately make compliance and associated costs more straightforward for lenders, which could result in lower costs to borrowers.
- Whilst there are consumer protections and benefits under the OFT regime, the FSA has the ability to make rules, not just guidance, and requires regular reporting.

Q3: 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?

It is essential that consumers do not lose the protections available under the OFT regime. We believe that a singular, strong regulatory framework should take account of the differences between first and second-charge lending and encompass the best consumer protections of both existing regimes.

⁵ Our response to the full MMR can be found at http://england.shelter.org.uk/professional_resources/policy_library/policy_library_folder/response_-_fsa_mortgage_market_review

For example, with a Consumer Credit Act loan, judges have the discretion to effectively re-open the loan and reduce the payments by extending the term or changing the interest rate, by use of a time order. Judicial discretion with first-charge residential loans is far more restricted – under Section 36 of the Administration of Justice Act courts do have power to adjourn possession proceedings or to make a suspended possession order, but only if it appears that the mortgagor is likely to be able to pay any sums due “within a reasonable period”. We believe that a ‘time order’ type system, or full judicial discretion, should apply to all mortgages so that courts can require reasonable and proportional action and require lenders to vary the terms of payment so that the mortgage becomes more affordable.

There is also a need to consider how other forms of credit are correspondingly regulated.

Q4: Do you believe there are any other ways to mitigate the potential future risks posed by second-charge mortgage markets?

No comments.

Q5: 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?

No comments.

Q6: Do you agree that FSA regulation of second-charge mortgages should be limited to lending to individuals and trustees?

We agree.

Q7: 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 agree. We note that loans secured by means of a charging order are excluded from the scope of the new definition. A potential risk is that lenders could circumvent regulation by selling unsecured credit with the intention of securing it via a charging order at a later date.

Q8: Do you agree that the regulated activities in relation to regulated mortgage contracts should apply to second-charge mortgages?

We agree.

Q9: Do you agree that the exemptions and exclusions that apply in relation to regulated mortgage contracts are appropriate for second-charge mortgages?

We agree.

Q10: Do you agree with the proposed arrangements for dealing with second-charge mortgages entered into before the date specified in the draft order?

We are concerned that only applying the new system to new mortgages could result in some consumer confusion. However, it would be difficult to apply regulation, such as new selling rules, retrospectively. There is a case for ensuring that rules around arrears and repossessions, which must be complimentary to the pre-action protocol, are consistent across all loans regardless of who the 'original' regulator was. This would ensure that consumers knew what to expect.

Chapter 3: Regulation of buy-to-let mortgages

Q11: Do you agree with the analysis of the buy-to-let mortgage market and the risks of market failure?

We believe that the lack of regulatory oversight in the buy-to-let market has been detrimental. Buy-to-let mortgages have fuelled the notion of property as a one-way financial investment with little responsibility attached. The buy-to-let market has also contributed, albeit not significantly, to house price inflation.⁶

Buy-to-let mortgages are slightly different to other types of mortgage, in that poor lending decisions or poor arrears management can have damaging effects on both the borrower (landlord) financially, and on the tenant in terms of their housing stability.

Particular problems in this market include:

- With little by way of affordability checks or scrutiny of business plans, amateur landlords were allowed to enter the market despite having no credentials for how they would manage their finances, or indeed their tenants. This failure to ensure lending was sustainable has led to an increase in landlord mortgage arrears and repossessions – with obvious detriment to tenants who may have to move home if their landlord defaults, or may find that the landlord can not afford to pay for repairs and maintenance.
- Recent Shelter research into the effects of the recession on the private rented sector showed that around 1 in 10 landlords were constantly struggling or falling behind. Of newer

⁶ NHPAU Research Findings Number 1: Buy-to-let mortgage lending and the impact on UK house prices, NHPAU 2008

landlords – those who entered the market less than five years ago – this rose to more than half.⁷

Q12: Do you agree that FSA regulation will mitigate the risk of market failure in the buy-to-let mortgage market?

We agree that FSA regulation, including both prudential and conduct of business rules as well as access to the Financial Ombudsman Service (FOS) would help to reduce risk in the buy-to-let sector.

There are systemic problems with professionalism of landlords in the private rented sector. Whilst we do not believe that these can, or should, be entirely addressed through regulation of landlord financing and the sales process, there is clearly a role for lenders in ensuring sustainability of loans. This role is not presently being fulfilled consistently. For example, the major Rugg/ Rhodes review of the private rented sector recommended that:

*“Applicants for buy-to-let mortgages should be required to demonstrate sound understanding of their local market and provide an appropriate business plan. Mortgage lenders and property developers have been culpable in promoting the idea that purchasing a property to let is an investment activity that requires little knowledge of the rental market or of tenancy law”.*⁸

There are challenges to regulating this market given the complex nature of the product. But we believe that a loan is a loan – and lenders should always be obliged to ensure it is affordable. The FSA notes, in its Mortgage Market Review, that other EU countries do not distinguish between regulation of residential loans and (equivalents of) buy-to-let, and we see no reason why this could not be replicated in the UK.

Q13: 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?

No comments.

⁷ *Taking the strain: The private rented sector in the recession*, Money Advice Trust & Shelter, 2009

⁸ Rugg, J & Rhodes, D *The private rented sector: its contribution and potential*, Centre for Housing policy, University of York, 2008

Q14: Do you agree that FSA regulation of buy-to-let mortgages should be limited to lending to individuals and trustees?

No. There is clearly a big difference between large scale professional letting businesses and small scale individual landlords, and we recognise that they require different regulatory treatment. The FSA's Mortgage Conduct of Business rules (MCOB) in their current form, for example, would not be appropriate for business to business lending. But this does not mean that lending to businesses should go completely unchecked. It is very easy to set up as a limited company and many individuals, such as contract workers, do so. An individual landlord with a small number of properties could set up a limited company and their loan would not need to be regulated – this does not appear to achieve the desired policy goal and could result in gaming of the system.

Q15: Do you agree that the proposed new condition relating to the use of property as a dwelling would include buy-to-let mortgages and continue to include residential mortgages?

We agree.

Q16: Do you agree that the regulated activities in relation to regulated mortgage contracts should apply to buy-to-let mortgages?

We agree.

Q9: Do you agree that the exemptions and exclusions that apply in relation to regulated mortgage contracts are appropriate for buy-to-let mortgages?

We agree.

Chapter 4: Protecting borrowers when mortgages are sold on

Q18: Do you agree with the analysis of potential consumer detriment in the market for the onward sale of mortgage books?

Yes. We identified this problem in our research report 'Uncharted Territory' in July 2009:

"There were some concerns about forbearance in situations where specialist lenders had sold on their mortgage books, sometimes to investment companies whose core business was not mortgage lending". One borrower interviewed, whose loan had been sold on, encountered difficulties with the new company: "This new lender sent automated arrears letters... but the lender did not respond to the borrower's letters requesting to take up these options... the lender was unable to provide a person to help".⁹

⁹ Ford, J, & Wallace, A., *Uncharted Territory? Managing mortgage arrears and possessions*, Shelter 2009

If firms are not subject to FSA regulation and have no regulatory or commercial reason to treat borrowers fairly, there can be real detriment to consumers. This is manifestly unjust as borrowers may not know that their mortgage has been sold on and do not have any control as to who it is sold on to. This undermines the whole notion of consumer choice.

Q19: 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?

We agree that the FSA must intervene when lenders – particularly defunct lenders – have sold mortgage books on to unregulated firms such as hedge fund investors.

Q20: Do you agree with the costs and benefits of the options under consideration in relation to protecting borrowers when mortgage books are sold on, as set out in the Impact Assessment?

No comments.

Q21: 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 agree.

Q22: 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 agree.

Q23: Do you consider that there will be further costs and benefits of the options under review when these options are combined, which are not reflected in the Impact Assessment?

No comments.

Shelter Policy Team

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