Consultation response

FSA Mortgage Market Review: Responsible Lending

November 2010

shelter.org.uk/policylibrary

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 40 advice services
- Shelter's free housing advice helpline which runs from 8am–8pm
- Shelter's website (shelter.org.uk/getadvice) 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, who 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 antisocial 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.

Shelter has been involved both in delivering services to struggling homeowners and in campaigning for better protections for homeowners since the start of the recession.

- In the last year more than 35,000 people visited our web advice pages for mortgage arrears and Support for Mortgage Interest. Almost 70,000 people have downloaded Shelter advice guides on mortgages.
- Our dedicated 'homeowner helpline' staff take around 300 calls relating to mortgage arrears and repossessions every month
- There is high demand for mortgage debt 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

Introduction

Irresponsible lending can have devastating consequences, for individuals living on the margins of affordability and for the wider housing market. The mortgage lending market has undoubtedly contracted since the credit crunch, but Shelter believes that it is imperative to introduce robust regulation to finally put a stop to reckless lending decisions. We do not think that our housing crisis can be solved by pumping credit into the market at a time when housing supply is so low and constrained compared to demand.

Shelter welcomes the FSA's new proposals on mortgage lending and the evidence based, thorough approach it has taken in formulating them. More effective and interventionist regulation of mortgage lending can make a vital contribution to stabilising the over inflated and volatile housing market, embedding responsibility and sustainability into home ownership, and reducing indebtedness.

Regulation of mortgage lending is complex, but a straightforward and common sense principle, that lenders should only make loans which borrowers can realistically afford to pay back, must underpin the credit market. The consultation paper notes that low interest rates and lender forbearance have been masking the true level of personal indebtedness. We agree with this conclusion.

- Recent research into voluntary repossession highlighted that "possessions (and even arrears) do not adequately reflect the extent of unsustainable homeownership. The conclusion drawn… in the early 1990s that possession was only the tip of the iceberg remains true today."[1]
- Press reports have recently cited Council of Mortgage Lenders figures suggesting that three million borrowers could struggle if interest rates rise by two per cent.[2]
- Meanwhile, Shelter research indicates that 18 per cent of mortgagors are constantly struggling to keep up with their mortgage payments and two per cent are falling behind with their mortgage payments. Some 29 per cent of homeowners are worried about losing their home in the next 12 months.[3]

The FSA's own data shows that nearly half of mortgagor households have either no money or a shortfall after living costs and housing costs, a stark statistic which further highlights the extent of our affordability crisis. If households cannot save they will not be able to cope financially with life changes, or payment increases. Affordability is particularly acute for lower income households - our own research shows that low income homeowners are more vulnerable to repossession, and that some households who have been through a payment difficulty and received a Suspended Possession Order will have very little income left after mortgage payments - in 30% of cases in our sample, households would be pushed below the poverty line.[4]

High housing costs make life a misery for thousands. Less risky mortgage lending cannot solve this problem on its own, nor can it prevent unpredictable payment problems caused by job loss, sudden and severe income drops, relationship breakdown and so on. But irresponsible lending does exacerbate these problems. A mortgage that pushes household finances as far as they can go at the outset will put households on the brink of affordability, and even a modest drop in income could push them over the edge. Unaffordable credit is not a sustainable solution to unaffordable housing costs.

---

[1] Ford, J. et al, *Giving up home ownership: A qualitative study of voluntary possession and selling because of financial difficulties,* Communities and Local Government, 2010

[2] The Daily Mail, Millions *in cheap home loans trap: 'Zombie' households walking blindly into financial oblivion when rates rise*, 03 November 2010; The Sunday Telegraph, *Rate rise threat for 3m home owners*, 31 October 2010

[3] *Shelter response to latest Council of Mortgage Lenders repossession figures*, Shelter press release 11 November 2010. All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 2234 adults. Fieldwork was undertaken between 10th - 12th August 2010. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

[4] Bronk, V. et al, *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, 2009.

Case study: the effects of unaffordable loans

One Shelter client's mortgage payments were around £850 per month, along with a second charge loan of over £130 per month. But the client earned just over £210 per month, with additional support through child benefit, child tax credits and child support payments for three dependants. This discrepancy was partly due to loss of income following a recent relationship breakdown, but the adviser suspected that the mortgage had never really been affordable from the start – the client was in over 17 months worth of arrears just four years into the mortgage. The client was extremely distressed when she came to Shelter, having just received a notice for eviction.

Risks and policy dependencies

Regulation of residential mortgage transactions will not be effective if other sources of credit remain poorly regulated. We urge the Government to take forward its commitment to consider whether the "extensive legislative framework underpinning consumer credit regulation might be simplified and whether it should be brought under a single regulatory regime."[5] This must include buy-to-let mortgages and second charge mortgages, with appropriate nuance to take account of the different nature of these loans. Poor, worse, or no, regulation of these areas would seriously undermine the FSA's goals. It would not be fair if landlords were able to access investment properties with little by way of checks or balances, whilst primary buyers looking for a secure home were locked out. Similarly - whilst recognising the context of public spending cuts and changes to the regulatory architecture - we emphasise the need for the regulator to monitor and enforce robustly; adequate resource must be available for this to happen.

Neither should the mortgage market be seen entirely in isolation from the rest of the housing market. Households who cannot become homeowners through mortgage credit still need to be able to access a decent, secure and affordable home, and at present neither the market nor the state can guarantee this. Clearly, the FSA does not have control over the wider housing market, but we urge it to continue dialogue with other government departments with responsibility for housing issues. Equally, issues concerning first time buyers' ability to buy will not be solved through loosely regulated credit. Instead it will require a significant increase in housing supply to make prices more affordable relative to income.

First time buyers and market innovation

We believe these proposals will protect borrowers from bad deals. As long as lenders use the flexibility within the rules, we do not think anyone who can genuinely afford a mortgage will be frozen out the market as a result. Some borrowers will not be able to get such large mortgages as they might have previously, and that entry to the market will be delayed for some. But we think that this is proportionate given the scale of the financial crisis – the era of soft touch regulation has to come to an end. For many first-time buyers, the main barrier to taking out a mortgage is the high level of deposit required for a mortgage, coupled with higher interest rates that lenders charge to new buyers to cover their own risks. The new responsible lending conduct proposals do not alter these facts.

The mortgage market is innovative, constantly adapting to new circumstances. Whilst this can be positive, it can also bring new risks, and the FSA will be better able to keep new practices in check if it is assured that the conduct of business rules are strong.

---

5 *A new approach to financial regulation: judgement, focus and stability*, HM Treasury July 2010

Affordability assessments

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

We fully support the FSA's proposals on income verification, which we believe will lead to more sustainable lending and borrowing. It makes complete sense that lenders should check that people borrowing huge amounts of money, probably making the biggest financial commitment of their life, have the income to pay it back.

The evidence on non-verified income mortgages is compelling. The FSA highlights that countries with the greatest availability of non-income verified mortgages have had the most devastating level of repossessions and that self-certification mortgages are almost four times as likely to be in arrears or possession as income-verified mortgages.

The proposals outlined give lenders adequate scope to choose their preferred methods for confirming that what the borrower states that their income to be is indeed accurate.

We do not think that fast-track mortgages should be excluded from this rule. Fast-track mortgages are clearly a distinct, and often less risky, product than self-certified mortgages. But it would not make sense to ban one product and retain the other, and we agree that this could lead to gaming of the system. Insisting on income verification for all mortgages is a more straightforward rule, and we do not believe it will cause any consumer detriment beyond customer's having to wait slightly longer before obtaining a loan. Providing a bank statement (for example) is not an onerous task. Where a customer is well known to the lender - for example where they also hold a current account with that lender - the process should not be difficult.

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

Yes, Shelter is supportive of the FSA's proposals for assessing income, which we believe offer genuine flexibility for lenders to look at individual borrowers' circumstances and make evidence-based judgements on their ability to make repayments. We believe that the breadth of acceptable evidence of income set out in the document should see no people who genuinely have the income to make their mortgage repayments frozen out the market.

We do have some concerns about the practicability of MCOB11.3.12R (2)(a) on assessing the variability of income over time. We are pleased that the FSA will look at redrafting this paragraph in order to ensure that this sensible ambition is workable in practice. It is important to recognise that many borrowers have ebbs and flows in their income and are able to manage this without difficulty, so greater flexibility in the article would be welcome.

Case study: mis-selling and failure to verify income

A couple seeking to release capital by remortgaging were given a loan of nearly £200,000 at a rate of over 10 per cent. With the term at 25 years, and the mortgagor 60 years old, this seemed unrealistic and unaffordable from the outset. When they got into arrears, they sought the initial mortgage papers. They were shocked to discover that the broker had made the application self-certified, perhaps because both of them had declared additional freelance income alongside their permanent jobs. The broker had also, without their knowledge, stated their income as £60,000, over triple what it really was. After completion, the mortgage had been almost immediately sold on and securitised. Following a complaint to FOS, the couple are pursuing legal action.

We believe that the income verification will not be onerous for consumers, as verification tools, such as bank statements or company accounts, will exist already and should be easy to supply. For example, we do not consider that this will prevent self-employed people from taking out mortgages, as annual tax returns combined with bank statements will provide evidence of affordability. This will normally mean that self-employed people will have to complete year's worth of tax returns for evidence, at the very least, which may mean some delay prior to applying for a mortgage. We think is reasonable given the risks of new businesses failing to generate profit as expected.

The key to the new rules working will be in lenders ability to ensure that the flexibility afforded in the rules is matched by flexibility in practice. For example, lenders may wish to avoid the additional costs of human (versus computer) verification of income documents or lending staff may not have the training or skills to make judgements on more complex personal finances, and may therefore be less inclined to consider lending to self-employed people or people with less typical income patterns.

To mitigate this risk, we believe the FSA must be absolutely clear that lenders should be lending to prospective borrowers with a range of income patterns and should work with the Council of Mortgage Lenders to ensure this is backed up with clear, strong guidance. This will help ensure that no households who can afford a mortgage are unduly frozen out the market. Furthermore, we recommend that random spot checks are used to ensure that lenders are not relying on unpredictable or illegitimate sources of income.

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

The suggested approach strikes a reasonable balance between practicality and regulatory effectiveness, allowing lenders to use whichever source of information or credit data models they find most appropriate but with strong FSA oversight. It is right that the FSA should be able to challenge lenders on their models. We agree that collection of information on credit commitments should be a mandatory part of any expenditure checking process. We would also urge the FSA to publish guidance and encourage sharing of good practice across the industry on appropriate use of models and techniques.

This approach is a considerable concession to lenders, and whilst we hope it will be effective we urge the FSA to keep this under review and introduce an industry-wide standard if lenders' own methods are not protecting consumers adequately.

The affordability assessment process is also an opportunity for borrowers to seriously reflect on their income and expenditure and consider their ability to repay. The process of calculating free disposable income promotes realistic, informed, and responsible borrowing as well as lending. For this reason, we favour transparent models that compel borrowers to list and think through their expenditure in combination with accurate statistical data, rather than use of statistical data alone.

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 agree with this proposal. Payment direct to creditors, or through solicitors on completion, may increase the administrative burden to lenders, but we believe this is proportionate to help those who are accumulating debt. We have no further information on the costs of implementing the rule for further advances.

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

We support this approach. Some consumers are likely to cut down on their expenditure after taking on a mortgage and lenders must take account of how realistic such plans are - if borrowers are committed to buying a home they should be able to demonstrate ability to budget effectively in advance.

In certain areas, borrowers are already likely to be paying rent at levels which leave them with little or no free disposable income, indeed many renters struggle to meet their housing costs. For example, Shelter research suggests that 24% of private renters, and 25% of social renters are constantly struggling to keep up with their rent payments.[6] Struggling to keep up financially is often very acute amongst lower income households, and in the context of recession.[7] Whilst this should not alter the approach to mortgage regulation, it does raise serious questions for government about the affordability of renting and how this affects tenure choices.

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

We agree that lenders should consider the affordability of both the interest and the capital sum in their calculations. We understand that this is standard practice amongst most lenders.

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

We agree that a standard 25 year maximum term should be used to assess affordability, so that terms are not overstretched to extend affordability. However, given increasing life expectancy, changing patterns in the labour market and the potential for a later retirement/ state pension age threshold to be set, this policy should be reviewed regularly.

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?

Testing affordability against future interest rates is key. Historically low base rates have kept mortgages cheaper than they might otherwise have been since 2009, but the amount of people struggling to pay or getting into arrears would undoubtedly have been higher without this, something many lenders had made little provision for. The government safety net, including Support for Mortgage Interest, is also ill-equipped to deal with fluctuating interest rates, as demonstrated by the frequent policy changes in relation to calculating SMI rates.

Those coming off fixed rates onto variable rates can be stung if rates have increased, and the mortgage application process should ensure that they are prepared for this.

Case Study: fluctuating interest rates and ability to repay

A caller to the Shelter helpline with three young children is stuck on a fixed rate mortgage until September 2011. At 5.99 per cent, this rate is significantly higher than the Support for Mortgage Interest she receives, leaving her with a monthly shortfall. If she is lucky, she may be able to remortgage to a lower rate. If she cannot remortgage to a lower rate her arrears will continue to grow and her family will be left vulnerable to repossession. This illustrates how interest rate changes can cause real personal distress, and the complex interplay between interest rates, lending, and mortgage safety nets.

This measure should be broadly consistent across the market, so we welcome the proposal that FSA publishes a guideline rate and that lenders can only use their own model if they can demonstrate that it is as robust as the FSA guideline. We are unclear as to why the forecast rate should be based on swap rates rather than base or LIBOR rates.

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?

[6] Unpublished research for Shelter by YouGov plc – see footnote 3.
[7] For example, 2009 Shelter research suggested that nine out of ten lower income private tenants were struggling or falling behind with their household finances. Reynolds, L. & Smith, J., *Taking the strain: The private rented sector in the recession,* Shelter and the Money Advice Trust 2009

The FSA's evidence starkly shows that credit impaired consumers are highly vulnerable to arrears and repossession. Mortgages for credit impaired borrowers can be more expensive than standard mortgages through higher borrowing costs and interest rates, so lenders are already protecting themselves - if not borrowers - to some extent. As lenders are now returning to the credit impaired market, this is particularly pertinent.[8]

We would hope that the wider range of proposals outlined in the consultation, particularly on income verification and affordability assessments, will ensure that credit impaired borrowers can only access mortgage finance that is affordable. Nonetheless an additional 'buffer' is an appropriate tool given the extent of debt and financial struggle in this sector.

The buffer could:

- Ensure credit-impaired borrowers have enough to service debts that do not show up in credit records as well as to service their mortgage and other commitments
- Allow credit impaired borrowers to save for a rainy day, which can help guard against arrears or against financial losses resulting from negative equity
- Help lenders de-risk and meet their capital requirements

We acknowledge that it is also likely to exclude some credit-impaired borrowers from the market, or at least delay entry. We consider that this is proportionate given the risks involved, and considering that credit-impaired sales only account for a tiny proportion of the market (3.2 per cent). However the buffer is set, it must be consistent across all mortgage lenders.

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

The lack of available data about extent of other debts again highlights the need for consumer credit to be regulated consistently, by one regulator. The buffer will not be effective if households are still able to access as much easy credit as they like elsewhere - including secured credit.

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

We agree that lenders must consider the plausibility of whether a mortgage will be affordable in retirement. This is particularly important in the case of interest-only mortgages, high LTV mortgages, and mortgages for borrowers that do not have a pension plan in place. In our last submission to the FSA we included a case study of a man in his 60s who was given a far bigger loan than he needed, had no income beyond state pension and very quickly fell into arrears. This sort of practice is unfair and unacceptable. However, we are pleased that the FSA has not set a cap at the state retirement age as many people work beyond this.

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

No, but we note that borrowers often remortgage or seek to change terms when they are in financial difficulty, so we do suggest that for borrowers who are struggling with arrears, lenders must be allowed to offer a range of help, as outlined in MCOB 13, and that fair treatment of these borrowers should be prioritised over and above lending rules.

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

We agree.

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

---

8 The Guardian, *The return of sub-prime: mortgage firms target 'overlooked' market,* Saturday 30 October 2010

We agree.

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

We endorse the FSA's proposal to provide transitional measures and to only implement changes when the market impact is clear. But it must not delay too much on these proposals. Responsible lending has been on the agenda for some time, and Shelter will continue to press the FSA to implement its rules as swiftly as possible.

The drafting of the rules has attracted considerable comment and criticism from lenders and trade bodies. Shelter is not in a position to say how lenders will interpret these rules, but it is clear that the industry must operate to a shared understanding and standard and we urge the FSA to offer training and guidance on putting the rules into practice once they are implemented. We also note that the rules are still in draft form and the FSA has acknowledged that some may need to be redrafted, so speculation as to how they might affect the market is rather premature.

We agree with the industry that further refinement is needed on rule 11.3.12, which can currently be read literally to mean that a loan cannot be given if it is foreseeable that a borrower will not be able to afford any one payment over the term (usually 25 years). The FSA has rightly said that it does not expect lenders to predict the future, but this rule as drafted could lead lenders to believe that they cannot loan if there is *any* degree of risk.

We also suggest that under rule 11.3.20, lending policies are made publicly available on request, to promote transparency and allow borrowers to make challenges to, or seek redress for, bad lending decisions.

Finally, advertising and selling techniques, alongside wider customer service standards, form a key part of what Shelter considers responsible lending. We hope that the next stage of the Mortgage Market Review, on selling and distribution, includes a review of MCOB 2 and MCOB 4 to assess the appropriateness of these regulations and promotes fair treatment of all borrowers from the very outset of the lending journey, ensuring that borrowers are well informed and understand risks.

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

The most concerning potential impact of income verification proposals could be on prospective borrowers with less straightforward income patterns, such as self-employed people or people who are employed on temporary or short term contracts. The concern is that the additional complexity of their finances could mean that it takes longer to gather and process evidence of their income. As above, we believe that these risks would apply only if there was a discord between the principles and practice of the FSA’s income verification principles, and would only delay rather than exclude borrowers.

Pakistani and Bangladeshi people are more likely to be in self-employment, so if this risk was true, it could have a disproportionate impact on households from these ethnic backgrounds.[9]

Temporary workers now make up 6 per cent of the workforce, an increase of 16 per cent on the same period in 2008, but females are 8 per cent more likely to be temporary workers than males.[10] If the risk is that temporary workers will find it more difficult to prove their income, even if they have been in temporary employment for a reasonable length of time and have a steady income. Income verification could therefore have a disproportionate impact on women.

---

[9] *Annual Population Survey*, January 2004 to December 2004, Office for National Statistics
[10] Steventon, A, & Sanchez, C. *The under-pensioned: disabled people and people from ethnic minorities*, Equality and Human Rights Commission, 2008

That the risk of disadvantage is more likely to impact on groups with protected characteristics emphasises the importance of ensuring that disadvantage is prevented through effective implementation of the proposals. Shelter is confident that the draft rules allow sufficient flexibility and we would encourage the Council of Mortgage Lenders to work with lenders to ensure the flexibility in the rules translates into practice, with all borrowers able to demonstrate their ability to afford a mortgage.

Product regulation

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?

We have no further comments, and continue to endorse individual affordability assessments to establish ability to repay rather than across-the-board caps. We note the Chancellor's proposal that such caps could be used as a macro prudential tool to control house price inflation. Whilst this might freeze out some borrowers, it would be an appropriate tool over the long term if the housing bubble over inflates and macro-prudential regulators need to step in.

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)?

We agree that the layers of regulation - more sustainable interest-only rules, income verification, full affordability assessments and a credit-impaired borrower 'buffer' - are sufficient to stamp out reckless lending to borrowers with multiple high risk characteristics.

Arrears charges

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?

Shelter welcomes the clarifications in the draft instrument. We believe this will force lenders to ensure charges relating to payment shortfalls reflect actual costs, and help to prevent practices whereby vulnerable borrowers are hit with excessive charges through the back door, e.g. high charges for letters and phone calls relating to payment shortfalls. These charges can push borrowers into even deeper financial difficulty and increase the risk of homelessness, so it is vital that charges are proportionate to cost, fair and consistent.

While we are supportive of the draft instrument, we question how full lender compliance can be enforced to prevent struggling borrowers from facing unfair and unclear charges in the first place without stronger requirements on lenders to publish this information. We believe that greater transparency from lenders on arrears charges is a vital way of empowering borrowers with the information they need to know their rights, make good choices and challenge any unfair charges. We would therefore urge the FSA to publish their baseline findings and explicitly require lenders to publish their arrears policy, including information about levels and frequencies of charges.

Case Study - unfair charges

Shelter advises many struggling homeowners who have been hit by excessive charges and put at increased risk of losing their home. One homeowner was taken to court by her sub-prime lender for arrears of almost £2,000 – some three-quarters of which were found to be charges that a judge ruled were unfairly imposed by the lender. The fees included more than £1,000 for 'litigation management' and £250 for 'arrears management', were imposed even though the borrower was never more than two months' behind on her payments. At the time of being taken to court, she was only £546 in arrears. In this instance, the judge threw out the case when it was revealed how much of the arrears were due to charges.

We appreciate the FSA's argument about the risk of introducing baselines on charges, recognising the diverse set-ups of lenders and the risk of price-capping. However, we feel the risk of lenders increasing their charges to the cap can be mitigated through the FSA making it very clear that they do not expect lenders currently not charging to start doing so, or to raise charges, and take punitive action against those who do. Lenders who are currently undercharging or not charging can be held up as examples of good practice and perhaps gain competitive advantage through positive coverage of this.

We fully support the FSA's proposal that charges for arrears should be based on the attributable cost of administering the charge. We agree with the criteria listed as 'likely to be reasonable' could be included in the cost of administering the charge, and the list of factors that cannot be included in administering arrears charges, such as the time of executive staff. However, we are concerned that the language here is vague and weak, (e.g. "it is not likely to be reasonable for the firm to take into account the cost of […]"), which could mean that it will be difficult to challenge lenders who are attributing unfair costs in the setting of arrears charges.

We agree with the FSA's recommendation that quarterly or annual fees should not be charged for short periods in arrears. We also support the proposal that arrears charges should be fixed fee, as the administrative costs should be the same regardless of size of mortgage.

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

Yes, Shelter supports the proposed amendments to MCOB 13.3 that limit the number of times fees for missed payments are charged. We believe it is vital that borrowers who are struggling to make payments to their mortgage are not pushed further into debt by additional charges.

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.

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?

N/A

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?

Yes, Shelter is supportive of broadening the application of MCOB to cover all payment shortfalls. This will close the gap that regulates arrears charges but allows borrowers to be hit with other big charges that can easily push them into arrears. This will help prevent short blips in borrowers' finances from spiralling further into financial difficulty. Struggling homeowners have told us that, on missing a payment, they have been immediately hit with disproportionately high charges, with debt piling up and becoming harder and harder to pay off.

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

No.

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)?

N/A

Responsible borrowing

In the last year more than 35,000 people visited our web advice pages for mortgage arrears and Support for Mortgage Interest and almost 70,000 people have downloaded Shelter advice guides on mortgages. Some 18% of homeowners are constantly struggling to pay their mortgage, 78% more than in 2009.[11]

While a large part of this problem is due to the reckless behaviour of unscrupulous lenders and intermediaries operating in an under-regulated market, we acknowledge that some of the problem lies with many borrowers who have not made good decisions about mortgages and have wilfully or unwittingly overstretched their finances to take out a mortgage that they could not sustain.

The lengths that some households have stretched their finances in order to own their own home can perhaps be explained by the lack of advantage offered by other tenures compared to home ownership. Meanwhile the high cost of mortgages can be explained by the high cost of housing and the recent lack of affordable credit. Until more homes are built, and access and conditions in other tenures are improved, the demand for home ownership will remain high and households will continue to overstretch themselves, making them particularly vulnerable to personal and external financial changes.

We believe that the FSA's proposals help close off opportunities for irresponsible borrowing by removing self-certification mortgages and introducing mandatory income verification. Additional measures, such as the proposed interest rate rise buffer and the 20 per cent affordability buffer for credit-impaired borrowers, will help ensure borrowers can sustain a rise in interest rates, and may help cushion the blow of a sudden change in their circumstances affecting their ability to pay their mortgage.

It is therefore important that prospective and existing borrowers are fully engaged in the risks and costs of home ownership, so that they can make well-informed decisions about mortgages.

As we argued in response to question 26, we believe lenders should publish their arrears policy, including information about levels and frequencies of charges. This will help to engage borrowers in understanding and quantifying the risk of taking out a mortgage and how quickly non-payment can lead to additional charges.

We welcome that MCOB5 requires lenders to illustrate in KFIs the impact that a change in interest rates could have on mortgage payments, as this helps borrowers understand the risks that external changes could have on their ability to pay their mortgage. We also welcome the increasing number of mortgage lenders providing mortgage calculators on their websites. These are important steps to ensure that borrowers are engaged in the weight of decisions to take out mortgages and the risks they face if interest rates or their personal circumstances change.

Many of the existing tools on the moneymadeclear website are helpful, and the development of additional tools on the website, better signposting to the website by consumer organisations and by lenders, would help to ensure that prospective borrowers have made a thorough assessment of the risk of taking out a mortgage. These measures must be coupled with a longer term programme of financial education that ensures that homeownership is understood in terms of its risks and costs as well as the benefits, such as building up capital, that it can bring homeowners.

---

11 *Shelter response to latest Council of Mortgage Lenders repossession figures*, Shelter press release 11 November 2010. All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 2234 adults. Fieldwork was undertaken between 10th - 12th August 2010. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

Cost-benefit analysis

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

The CBA suggests that these proposals are proportionate, will increase stability and, over the long term, promote economic growth. The modelling shows that arrears between 2005-09 might have been lower (by between 55,300 - 60,800 cases) and repossessions lower (by between 16,900 - 18,500 cases).

We have some concerns relating to paragraphs 84 and 85 on estimated loss of welfare to affected borrowers. In particular, we are concerned that households whose borrowing will be more constrained will take smaller mortgages, potentially on sub standard properties, and potentially choosing smaller properties where they may be overcrowded. This risk should be considered as a matter of housing policy and can only really be addressed through increasing housing supply. Furthermore, the new rules could stop households from overstretching to buy properties that are bigger than they need, so freeing these houses up for larger families and thereby rebalancing the overcrowding risk. At present, owners are far more likely to 'under-occupy' than households in any other tenure.

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.

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

No.

For further information please contact Nicola Hughes, Senior Policy Officer, on 0344 515 2055 or at nicola_hughes@shelter.org.uk