A Registered Charity

Financial Services Authority
Mortgage Market Review: Responsible Lending

Comments from the
Consumer Credit Counselling Service

Introduction

The Consumer Credit Counselling Service (CCCS) is the UK's largest dedicated provider of independent debt advice. CCCS welcomes the opportunity to comment on the FSA's consultation on responsible lending in the mortgage market (CP10/16).

As requested, these comments address the questions on interest-only mortgages (questions 16 to 22) and non-banks (questions 33 and 34). We will respond to the remaining questions in the consultation document by November 16.

By way of introduction, CCCS focuses on arrangements for the management and repayment of its clients' unsecured borrowings (principally credit cards and personal loans). In its client budgeting process, mortgage payments are treated as a priority. Therefore, CCCS does not capture details on clients' mortgages comparable to those on their unsecured borrowings.

Nonetheless, the mortgage market is of fundamental importance to CCCS's work for the following reasons:

- The number of clients counselled by CCCS who own their own home has increased significantly since 2007. In 2007 only 41.6 percent of clients were homeowners; in 2009, 49.1 percent of clients were homeowners.
- Clients with high mortgage payments are, other things being equal, less able to service their unsecured borrowings. Large mortgages therefore contribute to unsecured debt problems.
- We share the view that base rate at an historically unprecedented level, the various government initiatives and improved lender forbearance collectively disguise the full impact of unaffordable mortgage lending and the true extent of the vulnerability of many consumers to upward interest rate movement (Paragraph 1.4). Our own internal research (which we are happy to share with the FSA) indicates that CCCS clients are currently benefiting from an average windfall of over £100 a month on their mortgage payments from current interest rates. We therefore anticipate there may be a growth in mortgage repayment problems once interest rates start to rise to more normal levels.

In anticipation of a growth in mortgage repayment problems, CCCS established a dedicated mortgage counselling service in 2007 that supports its core consumer credit counselling service. The mortgage service counselled over 7,000 clients in 2009. Lenders have indicated to CCCS the importance of having an independent mortgage counselling service available in anticipation of a possible increase in mortgage repayment problems once interest rates start to rise.

Interest-only mortgages (Qs 16-23)

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

We believe that the FSA should be prescriptive in ensuring and defining a valid repayment method. Based on feedback from our counsellors, many CCCS clients have interest-only mortgages with life insurance but no other plans or repayment vehicles in place to clear their capital balances.

Only fixed value vehicles that are guaranteed to repay the mortgage should be allowed, and they should be linked so that the mortgage provider is aware of any variation or cancellation.

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?

We believe lenders should be required to check there is a valid repayment method in place at the start of the mortgage, and then annually through the term of the mortgage.

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?

We are not qualified to respond in detail to this question. In general, we believe that 'sale of property' should only be used where there the borrower has, or will have significant equity in the property. Further, lenders' assessment of equity cover should be based on conservative assumptions about house prices.

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?

In the list of customer types set out in paragraph 2.102, we are uncomfortable with the inclusion of "first time buyers who can afford the mortgage on a repayment basis but want to spend some of their income on home set-up costs during the initial period of their mortgage". Some of the excessive interest-only mortgage lending ahead of the crisis was to borrowers who mistakenly believed that interest-only arrangements were justified by optimistic assumptions about house price levels and trends. We believe first time buyers' should budget on the basis of repayment mortgage payments (or an appropriate repayment vehicle to cover the mortgage principal), with any initial interest-only arrangements subject to tight controls (see following answer).

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?

As above, we are nervous that temporary interest-only mortgages for first-time buyers may both lead to borrowers under-estimating the full cost of a mortgage (particularly in an environment characterised by below-trend interest rates) and be difficult for lenders to administer.

If first-time buyers are offered interest-only mortgages to help accommodate home set-up costs, there should be a maximum deferral term (e.g. 6-18 months), after which payments re-set to a full repayment basis. Further, such interest-only mortgages should have a stress test included to measure the client's ability to manage increases in interest rates as well as the capital payments once the interest-only period expires. Lenders should also offer clients a review meeting before the interest-only period expires.

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?

There is clearly a small number of customer types of the kind noted in the consultation paper where a repayment vehicle may not be necessary (as set out in paragraph 2.102).

Of the customer types listed (other than first-time buyers, who we address above), the greatest potential risks lie with older consumers who have accumulated equity in their property. We would often suggest, based on affordability, that a client should consider releasing the equity from their property in stages. Once the client has retired, or when the client wishes to have the security of a lifetime mortgage, they can then look at transferring the loan to an equity release plan, (this could be a plan with or without monthly payments). There should be a maximum loan for older clients wanting an interest-only mortgage that corresponds to the LTV's available in the equity release sector. A client should not have an equity release plan unless all other secured debts can be repaid from the funds released.

It would also be advisable for the client to confirm the eligibility of their property for an equity release loan prior to taking out an interest-only mortgage. Should the client not wish to take these risks, they could then consider an equity release lifetime mortgage, with monthly payments at the higher interest rate.

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

We have no specific reasons to believe so.

6 Non-deposit taking lenders (Qs 33-34)

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

In principle we welcome the proposed prudential regime for non-bank mortgage lenders, though we are not qualified to respond in detail to this question.

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

We believe macro-prudential considerations are important in monitoring the risks attached to mortgage and other household lending and borrowing. For example, the growth in household borrowing (both mortgage and unsecured) relative to GDP in the decade ahead of the crisis was an important indicator of macro-risk. Within this, the growth in the proportion of mortgages funded by non-banks rather than deposit-based banks and building societies was an important contributor.

However, in the current market, non-banks are less relevant to macro-prudential considerations given that (as the consultation paper notes) they have largely withdrawn from the market. With the significant fall in new mortgage lending since the crisis (and no near-term prospect of it reaching pre-crisis levels), we believe the focus now needs to be on the macro-prudential risks attached to the large existing stock of mortgages (in an environment characterised by abnormally low interest rates and, on many measures, elevated house prices).

Consumer Credit Counselling Service
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