StepChange Debt Charity response to the FCA's Mortgage customers: proposed changes to responsible lending rules and guidance CP19/14

June 2019

Introduction

StepChange Debt Charity is the largest specialist debt advice charity operating across the UK. In 2018, over 650,000 people contacted us for advice and information, an increase of 5% from 2017. StepChange's Financial Solutions service is established as a separate organisation, directly authorised as a mortgage intermediary by the FCA, which offers advice and the arrangement of both equity release plans and mortgages aimed at helping people out of problem debt.

Of the clients who we provided with debt advice in 2018, 16% had a mortgage and 18% of these had mortgage arrears, although this proportion has been falling since 2014 when it was 27%. In 2018, 30% of all our clients had a negative budget, which means their income was not sufficient to cover their essential expenditure. This had increased from 25% in 2014. 14% of clients with a negative budget had a mortgage, suggesting they would have to cut back on other essentials, or borrow, to maintain their mortgage payments at their current rate.

We are concerned that a combination of high housing costs and limited support for people struggling to maintain their homes is causing more people to resort to high cost credit or other forms of borrowing to cover mortgage payments. This may mask any appearance of direct mortgage repayment difficulties in the short term, but could make their overall financial position significantly worse. Twenty-nine per cent of clients we surveyed in 2017 said they were using high cost credit to cover their rent or mortgage payments[1]. Our view is that many households with mortgages are managing at the moment, but at risk of struggling, particularly if there is an interest rate rise and/or a fall in current property prices.

We therefore support the FCA's principle of making it easier for some people who are currently unable to switch to be able to move to more affordable mortgage deals. However, while we welcome the principle that more people should be able to switch where it makes sense for them to do so, we note that few of our clients (who would potentially benefit from switching) would be able to take advantage of the proposed changes, given that they may fall outside other lenders' risk appetite and/or may be on "closed books" with inactive or unregulated lenders.

Those of our clients with mortgage arrears will also remain ineligible to move to a more affordable deal, either with their current lender or another provider, under the current "up-to-date" with payments over the previous 12 months clause. This is despite the fact that many of these clients are financially vulnerable and working with us to repay their mortgage arrears: a more affordable mortgage deal would ensure they could repay arrears more quickly and/or reduce any other debts or arrears. It may be that paying the market rate on their mortgage repayments, rather than the standard variable rate, could have prevented these mortgage arrears in the first place. The FCA should consider how better outcomes for these customers could potentially be achieved, over and above current forbearance rules.[2]

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[1] StepChange Debt Charity (2017) The High Cost of Credit: the need for more affordable alternatives to high cost credit

[2] Correspondence between the Right Honourable Nick Morgan MP and Chief Executive of the FCA, 15 February 2019

The FCA states that "*some consumers suffer harm because they cannot switch, despite being up-to-date with payments. Our proposals in this paper aim to address this harm by modifying our responsible lending rules*." However, the current proposals will not on their own achieve this aim. They will not support many of those who currently find themselves trapped in mortgage deals that mean they are paying significantly more than the present low market rate, even if they are up to date with their mortgage payments. This is because there is no obligation on lenders to offer better deals to mortgage prisoners who are currently trapped on high standard variable rates. Some active, regulated lenders have not signed up to the voluntary agreement[3] to offer lower rates to existing customers and the offer of a better deal to new customers is purely dependent on the commercial risk appetite of the lender. Although the negotiation of the voluntary agreement amongst authorised lenders is a positive step forward, it does not address the problems of those customers of inactive lenders or unregulated firms who are currently unable to switch.

"*I was trapped in an interest-only mortgage without the ability to swap to a repayment mortgage so have paid full variable rate interest for 10 years"*
StepChange Debt Charity client, March 2018

The current proposals do not go far enough to address the detriment caused to current "mortgage prisoners" as a result of a structural problem in the mortgage market, and do not ensure that similar problems will be prevented for current and future mortgage customers. Given the length of a mortgage, and the fact that 50% of UK adults display one or more characteristics of potential vulnerability over their lives,[4] it is highly likely someone will find themselves in vulnerable circumstances during the lifetime of their mortgage. As the FCA states in its consultation paper on rent to own (RTO) and alternatives to high cost credit (CP18/12):[5]

"*We believe we need to intervene in the RTO market because a highly vulnerable group of consumers are paying too much for household goods. We understand that there is a cost to firms for the risk of providing credit, and there are significant risks involved in serving a population with low credit scores. But our view is that the prices firms charge for servicing a vulnerable consumer base can cause harm simply because they are too high."*

StepChange Debt Charity recommends a similar approach to address the structural problems in the mortgage market that mean many vulnerable customers are paying much more than the current market rate for mortgage products, and in some cases are at risk of repossession. In the case of authorised lenders, it is within the FCA's current powers to provide a more effective regulatory solution. In the case of mortgage loans that have been sold to firms that are not authorised for mortgage lending, so currently outside the FCA's control, there is a case for the FCA to work with HM Treasury to support new legislation to ensure this detriment is stopped and prevented from affecting current and new mortgage customers in the future. If it is agreed that mortgage lending should be

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[3] UK Finance Lenders to help "ineligible" homeowners tied to reversion rates switch products, 31 July 2018
[4] Financial Conduct Authority (2017) Understanding the financial lives of UK adults
[5] FCA (2018) Rent-to-own and alternatives to high-cost credit – feedback on CP18/12 and consultation on a price cap

regulated, it should be the whole mortgage market that is covered by this regulation to ensure consumer protection.[6]

A recent parliamentary debate on “mortgage prisoners and vulture funds” [7] and ten minute rule Banking (Small Business and Consumer Protection) Bill [8] gained strong support from a cross-party group of MPs to enable consumers to transfer mortgages between providers and to prohibit the sale of mortgage debt to unregulated entities. This suggests there is parliamentary support to introduce legislation that might help those “mortgage prisoners” not covered by the FCA’s current proposals or their current regulation.

“[Mortgage prisoners] were forced to keep their current mortgage and to pay lenders the standard variable rate, which was between 2% and 5% higher they would have paid on a market-leading mortgage. This does not sound like a high percentage, but even if people took out a mortgage of £100,000—much lower than the UK average, including in Scotland—in 2008 before the crash, it is conceivable that they could have paid between £2,000 and £5,000 a year on top of what they would have paid on a normal competitive-rate mortgage. Over 11 years, a bank could have been paid between £22,000 and £55,000 more by exactly the same customers who were told that they could not afford a cheaper mortgage.”
Alison Thewliss MP, 2019

Although outside the scope of this consultation paper, we also note that these changes will not provide more support for people, usually the most vulnerable,[9] who can switch from a standard variable rate but have not done so – and continue to pay a “loyalty premium” for their mortgage: an issue highlighted in the FCA’s Mortgages Market Interim report.[10] We welcome the FCA’s recent proposals to undertake detailed research to understand the characteristics of these consumers who do not switch, to inform any further interventions.[11] However, one of the challenges for customers in the current mortgage market is that there is no impetus for lenders to make them aware that other more affordable mortgages are available. When the FCA required lenders to do more to support their interest-only mortgage customers and issue them with guidance,[12] we believe that this had a positive influence within the market. For example, the total interest-only mortgage stock (including part and part) has reduced by 54% in number and 43% in value since 2012 and the number of interest-only loans at higher (over 75%) loan-to-values fell by 13.8% in 2018.[13] We therefore advocate a similar approach in switching from a standard variable rate mortgage to a cheaper product.

The regulator should consider a Mortgage Switch Guarantee that sets a higher standard of transparency for lenders and makes mortgage switching easier for their customers,[14] as part of its

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[6] Section 5 sub-section 2 Financial Services and Markets Act 2000
[7] House of Commons, Hansard (2019) Mortgage Prisoners
[8] House of Commons (2019) Banking (Small Business and Consumer Protection) Bill
[9] Competition & Markets Authority (2019) Consumer vulnerability: challenges and potential solutions
[10] FCA (2018) Mortgages Market Study: Interim Report MS16/2.2
[11] FCA (2019) Update on Citizens Advice super-complaint to the CMA
[12] FCA (2013) Finalised guidance: Dealing fairly with interest-only mortgage customers who risk being unable to repay their loan
[13] UK Finance (2019) Interest-Only Mortgages
[14] Mortgage Switch Guarantee

interventions to address the wider structural problems affecting the most vulnerable customers in the mortgage market.

"There is not enough support for people with enduring mental ill health and a mortgage. I had to give up a well-paid job and am unlikely to return to paid work. The benefits system is impossible to navigate with anxiety and depression, so it makes it worse. This left me to live on credit until I reached the limits because it was a more manageable solution than dealing with the benefits system. It's cost me tens of thousands of pounds and taken away a secure future. I have had to sell the home I've lived in for 34 years and cash in my pension. The breathing space [seeking debt advice provided] allowed me to sell my home with the support of my children and not the pressure of my bank."
StepChange Debt Charity client, March 2018

Q1: Do you agree that our proposals should only apply to firms dealing with consumers that meet the conditions of 'eligible consumers'?

We support the proposal that the FCA should introduce an affordability criteria waiver for customers, who when their deal ends find they are "mortgage prisoners" transferred on to a standard variable rate because they no longer pass new stricter affordability checks to switch to cheaper deals. However, this waiver should not just apply to firms dealing with consumers that meet the conditions of "eligible consumers", but to all mortgage lender firms, so these customers can explore the suitability of as many different mortgage products as possible. Although it is important that we do not see a return to some of the poor mortgage lending practices that occurred before the financial crash of 2008, new entrant mortgage lenders with specialist products for existing mortgage customers who have been in arrears may be excluded by the current "eligible consumer" condition. For example, some specialist lenders have introduced mortgage products for clients who are in active Debt Management Plans. All regulated active lenders, including new entrant firms, should be obliged (as under the current Voluntary Agreement [15]) to have a policy allowing customers to switch to a more affordable product to prevent later consumer detriment.

We note that "mortgage prisoners" with inactive or unregulated lenders may not benefit from these changes. Even if they receive notifications, their own lender will not be compelled to offer them a better deal and other lenders may be unlikely to see them as a target customer group. The FCA needs to consider how best to achieve better outcomes for this group of customers. This might mean considering what incentives might be appropriate to encourage sustainable lending by other lenders to meet their needs. It might mean making the case for legislative change as highlighted above.

"*The single change in my housing situation that would make the biggest difference to my financial situation is being able to re-mortgage at a lower interest rate."*
StepChange Debt Charity client, March 2018

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[15] UK Finance Lenders to help "ineligible" homeowners tied to reversion rates switch products, 31 July 2018

Q2: Do you agree that 'up-to-date with payments' should be decided by not being in payment shortfall, both at the time of application and over the previous 12 months?

As a debt advice charity, we are particularly concerned that the higher mortgage payments on switching to a standard variable rate may lead to those affected taking out credit to cover the difference, or falling behind on other bills because they do not want to fall into mortgage arrears. Either path risks escalating financial problems that could push people into problem debt, with its associated social costs – when more information about, and support to switch on to a cheaper mortgage deal, could prevent this cycle of events.

Many of our clients will have mortgage arrears but have been making regular payments on their mortgage as part of the debt management process. They would benefit from a more affordable mortgage which would support them to pay off their mortgage arrears more quickly. However, they would be excluded under the FCA's proposed definition of "up-to-date with payments".

The FCA states that it does "*not have the power to help consumers who cannot switch because they do not meet lenders' commercial risk appetite*." As "*lending remains a commercial decision*." This means that many current "mortgage prisoners" may remain unable to switch mortgage deals as a result of lenders' commercial decisions. However, under its current powers the FCA should make it an obligation that lenders offer more affordable mortgage deal switches particularly to the most vulnerable customers. In its Approach to Consumers,[16] the FCA confirmed their definition of a vulnerable consumer as '*someone who, due to their personal circumstances is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care'*. In its consultation on an RTO cap the FCA stated that "*We are acting here due to the specific harm caused to consumers using RTO (who are typically financially vulnerable) from the high prices they pay in the sector*."[17]

If the "up-to-date with payments" definition was widened to include people managing their debt repayments and on-going mortgage costs (including arrears repayments), who are some of the most financially vulnerable mortgage customers, it might help to extend access to more affordable mortgage payments to a group who would clearly benefit and are currently paying detrimentally high prices. In many cases this would allow them to begin paying, or increase the rate at which they paid off, their arrears and other debts.

We think that firms should be encouraged to use their discretion to apply the same approach to customers who would otherwise qualify if they were up to date with payments within the definition, but who technically fall outside it. And if firms choose not to apply that discretion, we think they should be required to pro-actively offer forbearance options instead to ensure customers do not experience financial difficulty as a result of being unable to move from a reversionary rate. It is only

[16] FCA (2018) FCA Mission: Approach to Consumers

[17] FCA (2018) Rent-to-own and alternatives to high-cost credit – feedback on CP18/12 and consultation on a price cap

by providing as many mortgage switching options as possible to “mortgage prisoners”, from active lenders that have a policy allowing consumers to switch to a more affordable mortgage at the end of the initial deal, that the significant consumer harm they suffer is most likely to be reduced.

“I very much appreciate the guidance and support given in setting up my Debt Management Plan. This has given me a clear and achievable target to being debt free and planning for the future.”
StepChange Debt Charity client with mortgage arrears, March 2018

This still does not fully address the position of customers on inactive or unregulated lender books. While we recognise the FCA currently does not have jurisdiction over these lenders, we recommend that the regulator works with the owners of such portfolios, and the regulated third party administrators who service them, to consider creative and pro-active solutions for such customers. At the same time support for new legislation to ensure current and any future mortgage book buyers are regulated by the FCA, in the longer term should continue.

Q3: Do you agree with our approach to defining a ‘more affordable’ mortgage, both where product or arrangement fees have been added to the mortgage and where they have not?

We agree with the approach suggested to define a “more affordable” mortgage. In the cases where product or arrangement fees have been added to the mortgage, it makes sense to highlight this to customers and ensure that the new mortgage is less than the customer would have paid on their existing mortgage deal over this time. This would ensure that there is no confusion over the mortgage repayment rate and the additional fees repayment rate. It also excludes additional fee repayments from a definition of “extended borrowing”, if the repayments overall are cheaper.

Q4: What are your views on a definition of ‘more affordable’ that refers to both the interest rate during any incentivised deal period and the new lender’s existing reversion rate at the time?

We agree that there should be an addition to the proposed MCOB 11.9.5R which would read: ‘the interest rate which would apply to the proposed regulated mortgage contract after any discounted or introductory period is no higher than:

• the interest rate currently being applied to the existing regulated mortgage contract, and

• where the existing regulated mortgage contract is still in a discounted or introductory period, the interest rate which would be applied to that contract after any discounted or introductory period.’

This would reduce the potential detriment for customers in vulnerable situations who may be less likely to immediately switch at the end of a discounted or introductory period.

Q5: Do you agree that we should allow lenders to extend the term of the mortgage when they undertake the modified assessment?

We agree that lenders should be able to extend the term of the mortgage when they undertake the modified assessment. This should include a requirement that lenders make this point clear to customers and inform them of how much extra they will pay overall as a result and that customers are signposted to free mortgage advice to support them to make a decision. There should also be a requirement that lenders consider income in retirement as part of the modified assessment, if the new extended term takes the customer past their anticipated retirement age. The FCA should monitor, through regulatory reporting, how often lenders apply this approach and in what circumstances, to ensure that extended deals are not being routinely offered to “mortgage prisoners” as an alternative to lower rates.

Q6: Do you agree with our proposal to only allow lenders to use the modified affordability assessment if they have a policy allowing consumers to switch to a more affordable mortgage?

Yes. This proposal should provide more consumer protection ensuring that customers are eligible for a better deal than the reversion rate once the introductory period rate ends. The FCA should move beyond the current voluntary agreement and **require** all active lenders to have such a policy, as several active lenders have not signed up to the current voluntary agreement. This should reduce the consumer harm caused by customers who are currently unable to switch paying significantly more than necessary for a mortgage product than others, simply because they applied for a mortgage at a time when mortgage affordability was less well regulated.

Q7: Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our income and expenditure rules (MCOB 11.6.5R to 11.6.15G)?

We agree that lenders that choose the modified affordability assessment could disapply the income and expenditure rules. This still allows for lenders to verify income and expenditure, in cases where they are concerned about affordability, which may be the case with some of the more specialist lenders offering deals to customers with mortgage arrears or other debts.

Q8: Do you agree that we should require lenders to consider whether the consumer’s income after retirement would be enough to enable them to meet their commitments under the contract?

Yes, lenders should be required to consider whether the consumer’s income would be enough to enable them to meet their contract commitments, if the deal is to extend beyond their expected retirement age. If this is the case, we would suggest that retired customers should be offered free, independent mortgage advice to ensure they are taking the best type of post-retirement mortgage deal for them. For those of retirement age there are a number of different post-retirement mortgage products, which can affect the security of a home, and the most suitable will depend on individual circumstances, and should include consideration of changes in circumstances such as relationship breakdown, illness or the death of a partner. If the mortgage would not previously have extended into retirement, but now will, there should be a more explicit requirement for independent, free mortgage guidance that can consider the full range of post-retirement borrowing options, including lifetime or equity release.

Q9: Do you agree that we should allow lenders that choose to use the modified affordability assessment to disapply our interest rate stress test rules (MCOB 11.6.18R to 11.6.19G)?

Yes. The fact that the customer is moving to cheaper mortgage repayments should provide more buffer room to cope with any increase in interest rates. The fact that they have kept up with higher repayments makes it more likely that the interest rate stress test is likely to be met than if they are unable to switch at all. However, if there is a significant extension to the mortgage term, there need to be alternative checks and balances to ensure that the short-term cash flow improvement to the borrower is not disproportionately outweighed by the long-term total cost they incur. We note that the Financial Policy Committee’s recommendation is that the interest rate stress recommendation does not apply to any one switching mortgage if there is no increase in the amount borrowed.

Q10: Do you agree that we should introduce guidance that, if considering future interest rate rises, lenders may wish to take into account the fact that the consumer is currently meeting payments at a higher rate than on the more affordable mortgage?

The fact that the consumer is currently meeting payments at a higher rate than on a more affordable mortgage lies at the heart of these proposals. Even for those who still have mortgage arrears or other debts, who are financially vulnerable, the fact that they would be better off on a more affordable mortgage than their present mortgage should be part of the FCA’s “Treating Customers Fairly” principle. We suggest that this consideration should go beyond guidance and always be a part of the lender’s consideration of the affordability of future interest rate rises.

Q11: Do you agree that we should allow lenders that choose to use the modified assessment to disapply MCOB 11.6.40G to 11.6.48R and MCOB 11.6.50R to 11.6.52G as long as the consumer is not trying to increase the proportion of the loan on an interest-only basis?

We agree that a customer on an interest-only mortgage who does not have a credible repayment strategy is already at risk of harm, but that this should not stop them from being able to switch to a more affordable mortgage. Therefore, the modified assessment should allow lenders who choose to use it, to disapply the FCA's rules and guidance on interest-only mortgages. However, it would be inappropriate for a customer who already does not have a credible repayment strategy in place to increase the proportion of a loan on an interest-only basis.

There is precedent for this type of common sense approach which was previously recognised by those lenders who offered "negative equity" home-mover mortgages in the past to people who needed to move (perhaps for work reasons), and where the overall risk to the lender was not significantly changed by virtue of transferring the mortgage to a different property.

Q12: Do you have views on whether the modified assessment should be available for home movers looking to switch to a new lender?

If customers are looking to move home to reduce their mortgage payments further, there should not be barriers to this, particularly if the customer is facing a change of circumstances that make downsizing a necessity. The modified assessment should therefore be available for home movers looking to switch to a new lender, with the proviso that the home move will offer further savings on their mortgage repayments.

"I am in a Catch 22. I think I am only capable of part-time work. This will cause problems in meeting mortgage payments for the remainder of the mortgage."
StepChange Debt Charity client, March 2018

Q13: Do you agree that we should require inactive lenders and administrators acting for unregulated entities to contact their customers and make them aware that our rules mean they may be able to switch to a new mortgage product with a new lender?

Much more needs to be done to ensure that inactive lenders and administrators acting for unregulated entities contact their customers and make sure they are aware that they can switch to a new mortgage product with a new lender. Citizens Advice has reported that in the mortgage market, letters are still used as the method of notification, and people are not invited to choose their preferred method of communication. They suggest that if customers are contacted using ineffective communication methods, it is less likely that they will make a proactive choice to remain with their current provider or switch to another.[18] All lenders should be required to send consumers periodic notices disclosing how prices have changed, to advise them of alternative more affordable deals, as well as where they can receive help and advice on switching, in the communication channel they request. Inactive lenders and administrators acting for unregulated entities should have to fulfil similar requirements, if current "mortgage prisoners" are to benefit from the changes the FCA is proposing.

However, notification is unlikely to solve these particular "mortgage prisoners"' problems. The FCA itself acknowledges that lenders may have a limited risk appetite to offer products to such borrowers who are not current customers. We do not believe the market can be relied upon to deliver good solutions for these customers, and we think this problem is amplified for any customer with debt problems. The FCA needs to give further consideration to approaches that address this problem, irrespective of whether customers appear to "engage" or not when they are notified.

We support the proposal of a triaging approach with the industry that limits the costs that could be faced by consumers in looking for a new mortgage deal.

Q14: Do you agree that administrators and inactive lenders should only contact customers that have a residential mortgage, that is not a lifetime mortgage, and who are up-to-date with payments and on a reversion rate?

By requiring one-off contact with only such a limited range of customers, the FCA is limiting the number of consumers who could benefit from gaining further support or advice about their mortgage and/or switching to a more affordable deal. Again, it is the most financially vulnerable customers with mortgage arrears who are most likely to suffer by continuing on a higher repayment rate, if they are not contacted.

As mentioned above, we do not see these proposals as likely to be effective in dealing with the problems faced by customers of inactive or unregulated lenders. Further proposals are needed to consider a regulatory approach that can adequately address their position.

Q15: Do you agree we should require lenders to give this disclosure?

We agree that there should be a requirement on all lenders to provide this disclosure to warn customers of any potential risks. The FCA should work with lenders to ensure that this is communicated as simply and effectively as possible in the communication channel preferred by the customer.

Q16: Do you agree we should require lenders to report data on use of the modified affordability assessment?

It is important that the FCA monitors the impact of any changes that it introduces to see if they are addressing the harm experienced by "mortgage prisoners" and to ensure there are no unexpected

[18] Ogunye. T., Rogers, C., Greenhalgh, L. & McCay, B (2018) The cost of loyalty. London: Citizens Advice

consequences. It is therefore essential that lenders are required to report data on their use of the modified affordability assessment and the number of successful switches that have occurred as a result of its use.

Q17: Do you agree that we should amend SUP to state that, where lenders have sold a mortgage using the modified assessment, they are not required to report the affordability data required in PSD

We think the data should still be collected and reported but flagged to show that the modification has been used. Without this data, the FCA will not be able to monitor outcomes effectively for customers who have switched using the modification, as the underlying characteristics of those customers will not be fully understood.

The need for the FCA to effectively monitor the outcome of any changes it introduces to responsible lending rules and guidance is essential if it is to be able to assess whether these changes are achieving its stated aim of addressing the harm some consumers experience because they cannot switch mortgage product, or whether the changes are causing any unintended negative consequences. More direct intervention needs to be considered if the FCA's changed regulations and guidelines do not achieve their stated aims and we continue to see significant consumer detriment for those unable to switch in the mortgage market.

"It looks like I will lose my home, which makes me angry, as I have done everything the correct way e.g. had mortgage protection insurance, drew down 25% of workplace pension, spent all the savings I had. I'm angry because I paid [an] extortionate amount into the system."
StepChange Debt Charity client who had to give up work to care for her mother, March 2018