CONSUMER CREDIT Counselling Service

A Registered Charity

# Financial Services Authority
# Mortgage Market Review: Responsible Lending Consultation – Part 2

# Comments from the Consumer Credit Counselling Service

## Introduction

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

We have already responded to the questions on interest-only mortgages (questions 16 to 22) and non-banks (questions 33 and 34), to which the FSA requested responses by September 30. This response covers the remaining questions in the consultation document.

**Background**

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 the same level of detail on clients' mortgages as on their unsecured borrowings.

Nonetheless, the mortgage market is of fundamental importance to CCCS's work for several reasons. The number of clients counselled by CCCS who own their own home has increased significantly during recent years. In 2007 only 41.6 percent of clients were homeowners; in 2009, 49.1 percent of clients were homeowners.

Further, 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.

**Mortgage repayment problems**

Many of CCCS's clients have mortgage arrears. During the first nine months of 2010, of the clients identified as homeowners, 35 percent were in mortgage arrears (see Appendix 1). Of the clients who received a specific mortgage counselling session, 87 percent of clients for this service were in mortgage arrears (see Appendix 2).

Though the overall level of mortgage repayment problems has been lower during the last two years than anticipated at the height of the financial crisis, we believe problems may rise during the coming years. We share the view expressed in the consultation document 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 (Paragraphs 1.4, 2.10).

The consultation document cites data indicating that the median monthly reduction in mortgage payments for borrowers who obtained mortgages in 2007 and either reverted to the lender's Standard Variable Rate (SVR) or remortgaged in 2009 to 2010 was £140 (Paragraph 2.10).

The findings of our internal analysis of CCCS client data (which we are happy to share with the FSA) are similar. On a like-for-like basis, it appears that CCCS clients' average monthly mortgage payments fell by approximately £130 between 2008 and 2009. Given that base rate was close to its long-term average for most of 2008 (a little above it for most of the year), this implies that CCCS clients' average monthly mortgage payments are currently over £100 below normal levels.

We therefore believe there is a significant risk of an increase in mortgage repayment problems once interest rates start to rise to more normal levels. Indeed, there may be risks even before interest rates start to rise, given recent signs that house prices may be starting to decline and with Government spending cuts soon to take effect. For example one cut which is likely to have an immediate impact is the 40 percent reduction in the benefit payable in the form in mortgage interest relief (SMI) to eligible homeowners who have lost their jobs.

We anticipate use of CCCS's dedicated mortgage counselling service increasing as these factors take effect. Lenders have indicated to CCCS the importance of having such an independent service available in anticipation of a possible increase in mortgage repayment problems once interest rates start to rise.

We believe the availability of independent mortgage counselling needs to be incorporated into the FSA's standards of good practice on mortgage arrears management and charges.

**Additional information**

We have included two appendices containing data on CCCS clients for the first nine months of 2010 that maybe helpful. The appendices contain data on:

1. All clients counselled by CCCS broken down housing status, including the proportion in arrears.
2. CCCS clients who received a dedicated mortgage counselling session, including data on the proportion in arrears, proportion with an arrangement in place, and average unsecured credit commitments.

We have also included a copy of the financial statement CCCS uses in its own client counselling. This may be helpful as the FSA finalises its proposals on the calculation of expenditure and free disposable income.

## 2 Affordability assessments (Qs 1-15, 23)

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

We agree with the principle that lenders should verify income for mortgage applications.

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

We agree that there needs to be flexibility in how lenders assess income. The attached financial statement lists the main categories of income CCCS checks for in its client counselling.

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

We agree in broad terms with the approach to assessing expenditure. The categories in the schedule for the calculation of free disposable income (Exhibit 2.7) broadly match those in the CCCS financial statement (copy attached), though the latter goes into greater detail (and, given its primary purpose, unsecured credit commitments are captured separately).

CCCS assesses client expenditure against annually updated budget guideline figures. These help to provide clients with a workable budget and to ensure that creditors accept repayment proposals from the charity.

If helpful, we would be happy to provide the FSA with further information on our budget guidelines and any other aspects of our assessment of expenditure as it takes forward the proposals.

**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 that lenders should be required to ensure that credit commitments being cleared by debt consolidation are repaid as expected.

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

We agree in principle with the approach to calculating free disposable income.

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

We agree.

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

We agree.

**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?**

We agree with the principle. We think it particularly important in the current climate that lenders take account of likely movements in interest rates during the lifetime of the mortgage given that rates are at such abnormally low levels.

One approach might be to look at base rate (or some other measure of the cost of funds such as swap rates) during a period of trend rates of economic growth (or during a period sufficiently long such that the average approximates to the trend rates) and the target rate for inflation.

For example, our calculations indicate that base rate averaged 4.8% from the start of the decade to early October 2008. Arguably, base rate was too low during this period given the asset price inflation, particularly in the housing market. However, with economic growth around 2.5% and inflation around 2.5%, one would expect base rate to be close to 5% (giving deposit-holders a real return of around 2.5%) and average mortgage rates approximately one percentage point higher.

Clearly, more sophisticated calculations are required and these are intended to be indicative only. However, in principle the affordability of mortgage payments might be assessed against a margin above interest rates during a period of trend economic growth and target inflation.

One factor that needs to be taken into account in developing a guideline margin is the impact of fixed-rate mortgages. Customers on fixed-rate mortgages may be particularly vulnerable during periods of above-normal interest rates if their fix ends during a period when fixed rates are below floating mortgage 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?**

While we agree in principle, we also believe it important to allow for credit rehabilitation. The consultation document states: "Where credit-impaired borrowers demonstrate that they can manage their finances, their credit-history will be naturally restored and they can apply for a mortgage without being subject to this restriction at that time." (Paragraph 2.72) CCCS believes further work is needed on how credit-impaired borrowers can demonstrate an ability to manage their finances, and would welcome (and be happy to contribute to) a FSA initiative on this topic.

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

We agreed with the approach, subject to allowing for increases in the state retirement age.

**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?**

We are not aware of any specific atypical lending circumstances which merit an alternative approach.

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

We agree, though lifetime mortgages may require separate consideration given growing life-expectancy and possible scenarios for UK house prices.

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

We agree with the approach proposed.

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

We have no additional comments.

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

While we are not aware of any impact, this is not a topic on which we have relevant data or undertaken any relevant research.

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

We agree in principle, though lenders may need to allow for changes in circumstances when assessing increases in existing loans.

For example, mortgage borrowers may have taken on additional consumer credit commitments (or repaid existing consumer credit commitments) since the time of the original loan application, with a bearing on the affordability of equity withdrawal. Alternatively, equity withdrawal may be used to repay existing consumer credit commitments. Clarification on these possibilities may be helpful in assessing the affordability of equity withdrawal.

## 3 Product regulation (Qs 24-25)

**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 believe it may be helpful to distinguish LTI and DTI ratios from LTV ratios.

LTI and DTI ratios are very similar, both relating the amount borrowed to the income of the borrower. Further, the fundamental respects, the affordability assessments set out in Chapter 2 of the consultation paper are proxies for, or refinements of LTI and DTI ratios.

LTV relates the amount borrowed to the value of the asset against which the loan is made. A loan may be affordable relative to the income of the borrower even if is a made on a high LTV ratio. If the affordability assessments are sufficiently rigorous, the borrower may be able to cope with any subsequent fall in house prices. However, according to the consultation document:

- The FSA's analysis of arrears and repossessions data found that LTV ratios are a relatively consistent predictor of default (Paragraph 3.9), and
- The consultation proposals may have an impact on house prices (Annex 1 – Part 1, Paragraphs 138-145)

According to the analysis presented in Annex 1 – Part 1, there is also evidence that "high LTVs are a less significant predictor of arrears for standard mortgages, rather than for credit-impaired and self-certified mortgages" (Annex 1 – Part 1, Paragraph 36). It may be, therefore, that the more rigorous tests of affordability reduce or eliminate the need to focus on LTV. However, given prospects for UK house prices, the FSA may want to stress test the relevance of LTV under a scenario of falling house prices.

**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 robust affordability assessment (including additional checks when the borrower is credit-impaired) are likely to prevent loans with the combinations of high-risk characteristics identified in Exhibit 3.1.

## 4 Arrears charges (Qs 26-32)

**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?**

We welcome the proposed changes on arrears charges.

We would add to the examples of good practice on the handling of mortgage arrears (Exhibit 4.1):

- The option of referral to an independent debt counselling service such as Citizens Advice or CCCS. We believe this particularly important given that many of those with mortgage arrears are likely to have unsecured debt arrears as well.
- The option of a telephone-based appointment with an internal debt counsellor and / or internet-based debt counselling advice, which is likely to be significantly cheaper than a debt counselling visit. CCCS' experience is that even clients with complex personal debt cases can be counselled by phone or internet, without the need for a face-to-face appointment.

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

**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?**

**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?**

We agree on the proposals to limit the number of times fees for missed payments are charged. We see no reason why the proposed changes cannot be implemented immediately, particularly given that lenders have been aware of the likely changes since publication of the consultation document.

**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?**

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

**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)?**

We agree that MCOB 12.4 and 13.3 should be widened to cover all payment shortfalls. Again, we see no reason why the proposed changes cannot be implemented immediately given that lenders have been aware of the likely changes since publication of the consultation document.

## Annex 1: Part 1
## Detailed cost-benefit analysis for proposals on responsible lending and arrears charges

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

We believe the FSA will need to monitor implementation to ensure that the measures do not unfairly advantage current account-providing banks (Annex 1 – Part 1, Paragraphs 95-99). .

Customers may instinctively choose the bank with whom they have a current account on the assumption that income verification will be easier.

## Annex 1: Part 2
## High-level cost-benefit analysis on current position on interest-only mortgages and non-banks

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

We have no comments.

## Annex 1 – Part 3
## Compatibility statement

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

We agree overall that the more rigorous assessment of affordability and tighter controls on arrears charges are beneficial to consumers. They are likely both to reduce the risk of loan arrears on future mortgages, and to better protect consumers from unmerited charges should loan arrears arise. However, there is a risk of consumer dissatisfaction given that some consumers who expect to qualify for a mortgage (and who would have done so before the financial crisis) may in future find themselves ineligible for one or may receive a lower mortgage offer than that applied for (as noted in Annex 1 – Part 1, Paragraphs 7, 13, 79-85).

**Consumer Credit Counselling Service**
**November 2010**

**Appendix 1: All CCCS clients counselled broken down by housing type, Jan - Oct 2010**

The following table provides information on all clients counselled by CCCS between January and October 2010. The figures cover both clients counselled by telephone and clients who used CCCS's internet-based Debt Remedy service.

The top line shows the total number of unique clients counselled. While the unique clients who specified mortgage/rent amount on budget may appear to be a low proportion, the vast majority of these are Debt Remedy clients (only 6% of whom specified their Housing amount).

The clients are then split into property owners and renters. Of each, the table shows what proportion are in arrears.

As we can see from the table, just over a third of property-owning clients were in arrears on their mortgages compared with just over 20% of tenants on their rent payments.

| **All Budget Clients** | |
|---|---|
| Unique Clients Counselled | 176,926 |
| Unique Clients who specified Mortgage/Rent amount on Budget | 74,189 |
| **Budget Clients who are Property Owners** | |
| Number of Budget Clients who are Property Owners | 42,618 |
| % Budget Clients who are Property Owners | *57.4%* |
| Property Owners in Arrears | 14,967 |
| % Property Owners in Arrears | *35.1%* |
| Property Owners Not in Arrears | 27,651 |
| % Property Owners Not in Arrears | *64.9%* |
| **Budget Clients who Rent** | |
| Number of Budget Clients who Rent | 31,571 |
| % Budget Clients who Rent | *42.6%* |
| Rental Clients in Arrears | 6,820 |
| % of Rental Clients in Arrears | *21.6%* |
| Rental Clients Not in Arrears | 24,751 |
| % of Rental Clients Not in Arrears | *78.4%* |

## Appendix 2: CCCS clients with a mortgage counselling session, Jan - Oct 2010

The following table provides information on all clients who received a mortgage counselling session with CCCS between January and October 2010.

The data is based on clients who have had a mortgage counselling session with one of CCCS's mortgage counselling centres (Leeds, Limavady and Glasgow), and is based on their most recent session between January and October.

Information on unsecured debts is not available for all clients that received mortgage counselling. The average unsecured debt outstanding and average number of unsecured debts are based on the 93% of clients that received mortgage counselling for whom data on their unsecured debts is available.

| | |
|---|---|
| Number with Mortgage Counselling Session | 1,942 |
| Number with Mortgage Arrears | 1,688 (86.9%) |
| Number with Mortgage Arrears AIP | 794 (40.9%) |
| Average Mortgage Arrears Amount | £4,804.57 |
| Average Mortgage AIP Payment | £103.84 |
| Number with Mortgage Counselling Session who have Unsecured Debt Information Supplied | 1,805 |
| Average Unsecured Debt Outstanding Balance | £22,084.67 |
| Average Number of Unsecured Debts | 6 |