Consultation Paper (CP 19/14) on Mortgage Customers:
proposed changes to responsible lending rules and guidance

Response by the Intermediary Mortgage Lenders Association

1st July 2019

IMLA

IMLA is the representative trade body for mortgage lenders who lend wholly or predominantly through intermediaries. Our 42 members include banks, building societies and specialist lenders, including 19 of the 20 largest UK mortgage lenders responsible for £230bn of annual lending. IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market. We welcome this opportunity to comment on the proposals set out in CP 19/14.

Summary of our views

1. The FCA's Mortgages Market Study concluded that detriment is being suffered by borrowers whose mortgages are owned by unregulated entities and who are unable to switch to cheaper products. The FCA has acknowledged that it has very little information on the precise numbers and circumstances of borrowers in this position – and accepts that it may transpire that relatively few can be offered alternative mortgages with different, active, lenders. Whilst the adoption of modified affordability assessments may help some of these borrowers, it is likely only to help a minority who fit the defined criteria.

2. We are concerned by the lack of information available about the target cohort of "trapped" borrowers: lenders will not be able to justify building new systems or modifying existing ones on the basis of such limited data as exists. We urge the FCA to conduct more detailed research into the characteristics of the target group and share this information with the industry before reaching final conclusions in its Policy Statement on this consultation.

3. We do not understand the logic of extending the modified affordability assessment to all borrowers who are seeking to re-mortgage. Such borrowers are already well served by a highly competitive market and are not, by definition, "trapped" or unable to find better deals. The FCA has indicated that it would be a commercial decision for each lender to decide whether to adopt modified assessment processes. We think it is unlikely that many will choose to do so, because the volume of potential business would not justify the cost and complexity involved in implementing new procedures. It is not a simple matter to "turn off" or disapply certain rules. The process of approving, adjusting and testing new and revised systems is likely to take many months to complete. This delay

will disadvantage the cohort of "trapped" borrowers which the amended rules were intended to help.

4. It will be very important not to raise borrowers' expectations unrealistically. The FCA has accepted that a number of borrowers will not be helped by the proposed amendments to the Rules. The FCA and Government should therefore consider alternative means of protecting those who remain unable to switch to cheaper products. First, it ought to be possible for the regulator to scrutinise arrangements where books of loans are sold, assigned or transferred. Second, there is a strong argument for expanding the regulatory perimeter so that entities which acquire books of regulated loans – which were sold under the MCOB regime – must comply with at least a minimal regulatory framework designed to protect the affected borrowers. Third, the Government should revive legislation which was drafted in 2013 and fairly well advanced before it was abandoned, or introduce new measures which would have a similar effect.

Answers to the specific questions posed in the consultation paper are set out below.

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

Yes. It is important not to lose sight of why the enhanced lending standards were introduced following the extensive consultation of the Mortgages Market Study. But given that there is a specific cohort of consumers who find their ability to switch products is constrained by those new standards, it does seem sensible and proportionate, where such consumers have demonstrated their ability to repay their loans by keeping up-to-date with their current payments and who do not want to borrow more, to allow lenders to disapply some of the requirements when assessing affordability. The proposals should however only apply to those consumers who are "eligible" and should not be applied more widely.

We do not understand the logic of extending the modified affordability assessment to all borrowers who are seeking to re-mortgage. Such borrowers are already well served by a highly competitive market, and are not, by definition, "trapped" or unable to find better deals. The FCA has indicated that it would be a commercial decision for each lender to decide whether to adopt such modified assessment processes. We think it is unlikely that many will choose to do so, because the volume of potential business would not justify the cost and complexity involved in implementing new procedures. It will not be a simple matter to "turn off" or disapply certain rules. The process of approving, adjusting and testing new and revised systems is likely to take many months to complete. This delay will disadvantage the cohort of "trapped" borrowers which the amended rules were intended to help.

It will be very important not to raise borrowers' expectations unrealistically. The FCA has accepted that a number of borrowers will not be helped by the proposed amendments to the Rules. The FCA and Government should therefore consider alternative means of protecting those borrowers who remain unable to switch to cheaper products. There is a historic precedent for this, in the form of a Department of the Environment 1989 Statement of Practice on the Transfer of Mortgages, which was adopted by the members of the Council of Mortgage Lenders and subsequently enshrined in the voluntary Mortgage Code. (A copy of the Statement is attached to this response.) **It ought to be possible for the regulator to scrutinise arrangements where books of loans are sold, assigned or**

transferred, to ensure that the borrowers affected are not treated less favourably than they would have been in the event that the original lender had remained the owner.

The Treasury has previously recognised that, where a *mortgage contract can be sold to an unregulated firm, the mortgage holder will lose the consumer protections given by FSA regulation (*[Treasury consultation paper] published in 2009). **There is a strong argument for expanding the regulatory perimeter so that entities which acquire books of regulated loans – which were sold under the MCOB regime – must comply with at least a minimal regulatory framework designed to protect the affected borrowers.**

The FCA has now clearly concluded that consumers who are unable to switch to more advantageous products are suffering detriment: if the case is strong enough, the Government should revive legislation which was drafted in 2013 and fairly well advanced before it was abandoned.

Lenders may need to discuss any plans to adopt modified affordability assessments with their supervisors. Those which securitise loan books are likely to find that the combination of increased credit risk and reduced margin will mean that the costs of funding will increase. What is the PRA's attitude towards lenders revising their risk appetites and potentially moving up the risk curve in order to help a cohort of borrowers, some of whom – arguably – should not have been given loans in the first place**?**

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?

Yes. Lenders will continue to review the broader financial position, by carrying out credit checks and assessing the payment history relating to unsecured loans and credit cards etc, to determine whether lending is in the consumer's best interests.

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?

Where there is no incentivised deal period under the proposed new mortgage, how can the lender ensure that the interest rate and monthly payments will be no higher "across the whole mortgage term" than those due under the existing mortgage? If there is no incentivised deal period – does that not imply that the proposed new mortgage is in fact on the (new) lender's SVR - which is, by definition, variable?

The new lender will presumably be required to establish what rate the customer is currently paying in order to ensure that the proposed new product is more affordable. It may not be straightforward for the new lender to verify this information: what standard of proof will be required? Will it be sufficient to obtain bank and/or mortgage statements from the consumer? The calculation will be even more complex where there is a combination of first and second charges, since the new lender will need to obtain information from more than one source.

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?

Why is the new lender's reversion rate (at the time the new product is offered) relevant, if the consumer is being offered a product with an incentivised deal period? Once offered a new product by an active lender, the consumer will be eligible, at the end of that product period, for another product either from that same lender or another lender. Reference to the new lender's reversion rate could also, as acknowledged in paragraph 3.17, make the new rules unavailable to building societies and challenger banks which have different funding models. It may be that smaller and specialist lenders, who can underwrite manually, may be more able to offer products to consumers who find themselves unable to switch. But some of those smaller lenders have higher SVRs and may therefore be prevented from offering products to potential switchers. This outcome would seem to be counter-productive -and perverse.

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

Yes, provided the consumer is given clear and timely information about the implications of this, as it is very likely that the overall total cost payable will be higher than if the term were not extended. We note the proposals in paragraphs 4.9 and 4.10, which require that the information relating to the cost of a longer term should be provided "no later than the mortgage offer document". It is likely that the consumer may be committed to the new product by mortgage offer stage – so it would be preferable for the information to be given earlier, to allow the consumer to make a properly informed decision. The new product may be more affordable in the short-term, if regular payments are lower, but will it be in the consumer's best interests if the total cost payable is higher? This is surely a judgment which must be made in the context of the individual consumer's circumstances.

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 – and referring back to our response to Q4, it would seem to render the issue of the new lender's reversion rate irrelevant. A consumer being offered a move away from an inactive lender or unregulated owner to a new, active, lender would be eligible for another product once the "new" product had reached the end of its initial term.

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)?

From discussions held during Roundtable events hosted by the FCA, we have understood that the proposals in 3.26 would effectively allow lenders to adopt a "pick and mix" approach to their modified affordability assessment, by disapplying some rules but not others. This does not seem to be reflected by the wording of MCOB 11.9.4, as set out on page 5 of Annex A to the CP, which states that: *The firm may not elect that only some of those modifications apply in relation to the proposed regulated mortgage contract, but not others.* In practice, lenders would probably want to take a view on which rules to disapply, and which not, according to each consumer's individual circumstances. For example, two consumers who were both self-employed at the time they took out their current mortgages might have experienced very different degrees of success and have very different earning patterns. It might not be appropriate or proportionate to apply the same degree of affordability assessment and scrutiny to both.

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: it is clearly essential that proper consideration should be given to this.

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)?

One of the consequences of the provisions in MCOB 11.6.18R to 11.16.19G has been a rise in the number of consumers taking out products with a term of 5 years or more – and thereby avoiding the requirement for repayments to be stress-tested. Not all lenders will be able to take full advantage of the proposals allowing them to choose to use the modified affordability assessment to disapply the stress test rules, however, because they will be constrained by what their systems will allow them to do.

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?

This is a logical extension of the previous point. There may be a question of degree and the likelihood of a steady upward trend in rate increases, which will affect individual consumers differently according to the remaining term of their mortgage and the amount still outstanding.

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?

Paragraph 3.36 recognises that it would be "clearly inappropriate" for anyone to take on a new interest-only loan without having a credible repayment strategy in place. Those who did take out such loans should – arguably – not have been able to do so. The resulting dilemma that many now find themselves in – of having no credible repayment strategy and no realistic means of repaying the capital – presents a problem both to them and to their existing lender/the owner of their loan. But enabling those consumers to take out a more affordable loan – which is still interest-only – merely shifts the problem to another lender – and it may well be that few lenders will be prepared to take them on.

It is possible that some lenders might be prepared to look at cases where there is a genuine prospect of the consumer moving onto a part-and-part interest and repayment product, and begin to make some inroads into the capital debt owed. To that extent, it might be helpful if such lenders were able to disapply the rules referred to as long as the consumer was not trying to increase the proportion of the loan on an interest-only basis. This is likely to be a highly specialist area, however, and unlikely to be available to significant numbers of interest-only borrowers who have made no effective provision for repaying the capital.

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

On balance, we would say no – at least for the present. The arguments for applying the modified assessment to home movers is not obvious: even where the intention is to "downsize" the profile of income and expenditure will inevitably be different, which means there is no simple "like for like" comparison. Quite apart from the costs of moving (stamp duty, valuation and legal fees, cost of physical removal of furniture and effects) there will be other costs such as Council Tax, and new contracts for provision of utilities. There may be reductions in some outgoings (expenditure on travel may be less; there may be no/less need to run a private car etc) but this may be quite difficult to quantify accurately.

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?

There clearly needs to be some form of communication with some customers of inactive lenders and unregulated entities – but simply sending out a single communication is highly unlikely to be effective. Paragraph 33 of the cost-benefit analysis set out in Annex 3 to the CP estimates that some 500,000 consumers will need to be contacted: but paragraph 71 goes on to note that *there are between 2,000 and 14,000 consumers who would be able to switch to a better deal as a result of our proposals.* The gap between 14,000 and 500,000 would seem to represent an awful waste of resource which could be better targeted – and the gap between 2,000 and 14,000 is also not inconsiderable.

To put this into a practical context – the response rate from consumers to lenders' earlier approaches offering product switches was very low – around 10%. There is no reason to believe this would be higher from a group of consumers who are more removed from their lenders, many of whom may have been disappointed/rejected in the past and therefore disinclined to engage again for fear of further rejection/embarrassment/humiliation.

Paragraph 1.18 of the CP acknowledges that there is no question of obliging lenders to take on consumers who currently have loans with other entities. This is welcome. Some may be prepared to develop products/draw up criteria which they may be prepared to accept/apply to individual consumers. Would it not therefore be more effective to require inactive lenders and administrators to review such products and criteria as may be developed by lenders – and then review their books to identify which consumers might then fit those criteria? It need not be a question of trying to match specific groups of consumers with specific providers – that would clearly be beyond the remit of the inactive lenders or third-party administrators – but some form of triage/referral could help to focus communications in a more constructive way.

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?

In principle, yes, but in practice, great care should be taken so as not to raise the expectations of large numbers of consumers who are likely to remain ineligible. In addition to the three bullet points set out in paragraph 4.5 of the consultation paper, there may be several other factors which would be relevant. The property's value may have fallen, leaving the consumer in negative equity. The consumer's personal circumstances (relationship/employment/health) may have changed significantly since the original loan was taken out. And whilst the consumer may not be in arrears (yet) – they may be relying on short-term assistance from friends and family – or the income from a business which may not be thriving - and not really be able to sustain repayments on a new deal by themselves. There may also be cases where a borrower took out a (residential) regulated mortgage contract, but has subsequently let out the property – in contravention of the terms and conditions of the contract with their lender. Such borrowers might therefore prove reluctant to engage with any communication from the administrators of their loan, for fear of exposing this situation.

Any new lender is likely to require further information, such as the length of the loan term outstanding, the existence of any repayment vehicle, where relevant, the extent to which a loan is part and part repayment or interest-only, and the income multiples/LTI which applied at the time the original loan was taken out.

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

Yes, lenders should be required to disclose this additional information – it would be prudent for them to retain copies/evidence in the event that they are subsequently challenged (by the consumer or regulator) to explain why they took the action they did.

It will be very important to warn consumers that whilst they may be offered a product which is cheaper in the short-term, there is a risk that they could end up on a higher reversion rate than their current mortgage rate – and the total cost payable at the end of the term may exceed what they had originally understood that total cost to be. Much will depend on their current circumstances, how motivated they are to try to move away from their existing loan arrangement, and how they view their future prospects if they stay where they are and risk the lender/owner seeking possession of the property if they are unable to repay the capital on an interest-only loan.

The third bullet in paragraph 4.9 proposes that the lender should disclose that the assessment of affordability *has not included any early repayment charges [the consumer] may have to pay to leave their current mortgage.* Surely the existence and likely amount of any ERC should be taken into account and explained to the consumer at an early stage, as it could make a material difference to the consumer's decision as to whether or not to take out a new product. Can it be assumed that the consumer would be receiving advice on any new product, in which case the adviser would be responsible for researching what amount might be payable under an ERC and calculating the relative benefit of redeeming early and moving onto a cheaper product, or waiting until the period during which an ERC applied had expired?   (Having said that, the majority of consumers who took out loans before the Mortgages Market Study rules came into effect in 2014 are now likely to have gone beyond the initial period during which ERCs would apply.)

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

It is understood why the FCA would want to capture this information: it will be for individual lenders to judge and comment on whether the additional reporting requirement is straightforward or sufficiently irksome to be a deterrent.

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

Yes: it makes sense that if lenders are to be asked to report data on use of the modified assessment, they should not also be required to report the affordability data required in PSD.