

30 September 2010

Ms Lynda Blackwell
Conduct Policy Division
Financial Services Authority
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By e-mail to: cp10_16@fsa.gov.uk

Dear Ms Blackwell

Consumer Focus response to the FSA Mortgage Market Review: Responsible lending consultation

Response to questions on interest-only mortgages and non-deposit taking lenders

Consumer Focus is the statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, Northern Ireland. We are the voice of the consumer, and work to secure a fair deal on their behalf.

We welcome the opportunity to comment on this consultation

Interest-only mortgages

We share the FSA's concerns regarding the expansion of interest-only mortgages to borrowers with no firm plan in place to repay the capital. This indicates that a large proportion of interest-only mortgage holders will not have the capital funds to pay off their mortgage. We are faced with the prospect of consumers being forced to sell their homes in the future (ie make themselves homeless) in order to repay their mortgages.

For these reasons, we feel that in relation to residential mortgages it is essential that the FSA is prescriptive in defining a valid repayment method. We are aware of the propensity of the financial services industry to expand the application of certain products to consumers for whom they are not appropriate unless they are constrained from doing so (eg mis-selling of endowments and the issues around self-certified mortgages).

In our earlier response to the Mortgage Market Review Discussion Paper, we expressed our doubts about whether interest-only mortgages should be considered appropriate for residential mortgages at all. However, we can see that there may be certain limited circumstances where an

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interest-only mortgage may continue to be appropriate. Nonetheless, we consider that there should be considerable restrictions on when an interest-only mortgage can be granted.

We strongly agree that house price inflation or an intention to 'downsize' should not be considered as a valid repayment method. Our view is that using the sale of the property as a method of repayment of the mortgage should not ordinarily be seen as a valid repayment vehicle, particularly where the mortgage is on the borrower's main home.

The paper refers to the risk of the consumer having to rely on the sale of the property being mitigated by the lender taking a more proactive role in monitoring the existence and adequacy of the repayment vehicle during the lifetime of the mortgage. On the face of it, this seems a reasonable measure, however we are concerned about what will happen if a lender finds that the repayment method either no longer exists or is no longer adequate. The consultation paper suggests that the lender would then transfer 'all or part of the mortgage to a repayment basis'. This is likely to be unrealistic in many instances, as a repayment mortgage will be more expensive than their current mortgage and these consumers may not be able to afford their mortgage on a repayment basis.

We can see the relevance of interest-only mortgages to consumers who have investment properties or second homes they can sell or high net worth consumers who have assets they can realise to repay their capital. We have considerable misgivings about first-time buyers being granted interest-only mortgages, rather than a repayment mortgage. In terms of older consumers, experience has shown that considerable care needs to be taken with any lifetime mortgages and older consumers considering this option need specialist financial advice. We do not think it is realistic to expect that people will downsize. We are uncertain what is meant by 'financially capable consumers' and how the lender would assess this, furthermore the paper has indicated the difficulty of guaranteeing any level of return on investments.

We would be very reluctant for the affordability assessment for interest-only mortgages to be relaxed, so that the lender can decide that it is appropriate to assess repayments on an interest-only basis, rather than a repayment basis. As we state above, we are concerned that giving this degree of flexibility to lenders could lead to similar problems to those we have seen in the past with the selling of inappropriate products to consumers.

We are concerned about the impact on consumers who currently have interest-only mortgages when they seek to remortgage. Clearly they will need assistance, but we do not feel that this should prevent rules being brought in now to protect consumers in the future. We suggest that if a borrower is unable to move to a repayment mortgage then their current lender should be obliged to continue to offer them an interest-only mortgage at a competitive rate until they are able to do so. It should also be possible, where appropriate, for borrowers in this position to have a part repayment and part interest-only mortgage until they are able to afford a full repayment mortgage.

We agree that a transfer to an interest-only mortgage should continue to be permitted as a method of forbearance.

We are not in a position to comment specifically on the issue of equity withdrawal.

Non-deposit taking lenders (non-banks)

The high level of arrears rates of non-banks illustrates the problems these types of institutions can cause to consumers by irresponsible lending. The instability that non-banks collectively can bring to the entire mortgage market is also a significant cause for concern. The enhanced conduct of business rules should reduce the level of risky lending by the non-banks, but we believe that the past volatility of these institutions makes the case for enhanced prudential regulation of the non-banks.

Nonetheless, we are committed to promoting diversity in the market and are concerned that increasing regulation and capital requirements on institutions that are considered risky may also create greater barriers to others who are genuinely offering different models. We are concerned that increased capital requirements across the whole non-bank sector may be detrimental to competition and propose instead these increased requirements should better reflect and differentiate on risk (and rate favourably other factors such as sustainability and public policy considerations). The characterisation should not necessarily be bank or non-bank. We also seek the application of guarantees and assurances sector wide, with contributions determined according to risk, based on an assessment of trading activities, rather than applying these just to the banks.

We hope that you find the comments in this response helpful. We would welcome the opportunity to discuss these issues further.

Yours faithfully

Marie Burton
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