CP19/14 Proposed changes to responsible lending rules and guidance

Date: 26 June 2019

Address: Laura Rodrigues
Financial Conduct Authority
12 Endeavour Square
London
SW20 1JN

Sent to: cp19-14@fca.org.uk

Introduction:

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms, we act to enhance competitiveness, support customers and facilitate innovation. We represent the full range of the industry from the largest lenders to the smallest, high street and challenger banks, building societies as well as non-banks and the regulated third party administrators who service inactive lenders. Our members include lenders who are fully intermediated and lenders who provide advice directly to customers.

We and our members have welcomed the participatory approach that the Financial Conduct Authority (“FCA”) have adopted in developing the remedies proposed in the Final Report of the Mortgages Market Study. We have worked closely with the FCA throughout the consultation period and hope to maintain this level of engagement during the implementation phase.

General Comments

Mortgage lenders welcome and support in principle, the flexibility being advocated, but there are areas which require clarity and guidance about the expected outcome. In particular the number of closed book customers who will be able to move to a new lender on a lower rate is likely to be only a small fraction of the total number.

After the Mortgage Market Review and implementation of the Mortgage Credit Directive lenders and advisers have developed policies and systems that meet the requirement to ensure customers can afford the mortgages that they are entering into. Any changes to the way that lenders assess affordability will take time to implement including systems and process changes, rewriting the firm’s responsible lending policies and staff training. Therefore, once any new rules are announced it may be some months before new lending policies are in place and borrowers are able to move to a better interest rate with a new lender.

Mortgages are long term products and customers have to be able to meet mortgage payments throughout the economic cycle. Some lenders are concerned that making significant changes to customer protection during a low interest rate period could result in poor outcomes for some consumers in the future.
Working with the wider regulatory environment

Lenders have to take account of a wide range of regulatory and legal requirements when entering into a mortgage contract as well as their own risk appetites and product sets. In particular lenders have to act in a prudent manner which means operationally being cognisant of any credit risk associated with new lending. So, the removal of an FCA regulatory barrier alone will not necessarily make it easier to move to a new lender.

It is important that there is a full understanding of the interplay between these proposed changes and the FCA handbook and other regulatory requirements, e.g. the limit of lending at an income multiple of greater than 4.49x. We would welcome confirmation in the final policy statement that the Financial Policy Committee and the Prudential Regulatory Authority (“PRA”) are fully cognisant of the changes to affordability assessment proposed.

Lenders will also have to assess their capital requirements against PRA rules and guidance and ensure that their lending matches the risk weightings they have reported. Interest only mortgages are particularly capital intensive and taking large numbers of these customers on could impact the availability of other mortgages to, for example, first time buyers.

There is a concern that the FCA’s focus on switching could undermine the nature and basis of long-term lending. One of the unintended consequences of this could be that lenders start to price for the shorter average duration of loans by recovering costs over a 2 year period rather than an assumed duration of say 7 years. In turn this means the customer will be required to keep on switching and could pay considerable additional fees over the mortgage lifetime.

Whilst the proposals are intended to make it easier for firms to lend to customers, they do not require firms to do so. Lenders are concerned that when a similar approach was taken with Transition Arrangement rules after the implementation of the Mortgage Market Review it became clear that over time expectations around these being optional changed and resulted in the potential for FOS upheld complaints.

Firms are concerned the Financial Ombudsman Service (FOS) and Claims Management Companies (CMCs) will claim that disallowing parts of the current affordability assessment is not responsible lending. The guidance that the FCA produces should set out the reasoning why disallowing parts of the affordability assessment may be seen as responsible, especially if the consumer has had a full affordability assessment on taking on the original mortgage.

Closed book customer data

The proposals are intended to allow the customers of closed book lenders to move to an active lender in order to obtain a lower rate of interest on their mortgage debt. However, UK Finance has very little information about the characteristics of the customers and the mortgages that are held by entities that are not authorised home finance lenders.

We recognise that the proposals under ‘CP18/41 FCA and PRA changes to mortgage reporting requirements’ require PSD performance data to be submitted to the FCA, but this is not scheduled to be available until late 2020. In the meantime, it would be helpful if the FCA could make a request for relevant data from the TPAs for mortgages that are owned by entities that are not authorised home finance lenders.

Many commentators are noting that customers of closed books are paying very high interest rates when some fixed rate mortgages are as low as 2.29%. However, we do not think all customers are on very high interest rates and not all customers will qualify for such low rates. Mortgage lenders charge higher interest rates on higher risks e.g. high loan to value (“LTV”) and poor credit record.
Different rates are also charged for different terms so a longer fixed rate may be more expensive than a two-year deal. This means that in reality many of the trapped borrowers will not be able to secure the lowest rates available in the market.

We do not know the interest rates the customers of closed books are paying. So the reversion rates may not be higher than fixed rates for high risk customers – the FCA’s Strategic Review Retail of Banking Business Models states that “Differences in default risk within the same loan category can also drive differences in yield; for example – holding other things equal – for a given type of lending, firms lending to ‘prime’ customers with good credit records and low expected default rates should expect to earn lower yields.” That Review also noted that different funding models may result in different interest rates to customers.

Given the age of these accounts many customers may be on favourable tracker rates - at say 0.5% over Bank Base Rate or LIBOR as these terms were commonly inserted into mortgage contracts at the time these mortgages were entered into.

Since the financial crash interest rates have been falling which means that many customers are on a much lower interest rate than they were originally on, even if they have been unable to get a new fixed rate mortgage. As a result, some customers who took out a mortgage relatively recently have not demonstrated the ability to pay in anything but a low interest rate environment.

The table below sets out the average interest rates for fixed rate mortgages at various LTV levels as at May 2019.

It shows customers with higher LTV and/or impaired credit pay a higher interest rate than lower LTV and/or prime customers reflecting the higher risk and costs of financing for lenders.

If a borrower has a low LTV they will be offered the lowest interest rate available to them (even if their LTV is below the range), so a borrower with 40% LTV would still be able to get the 2.29% rate offered to people with 56-60% LTV.

<table>
<thead>
<tr>
<th>Max. LTV %</th>
<th>Prime 2 year fixed</th>
<th>Prime 5 year fixed</th>
<th>Impaired credit 2 year fixed</th>
<th>Impaired credit 5 year fixed</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 50</td>
<td>3.05</td>
<td>2.64</td>
<td>4.32</td>
<td>5.09</td>
</tr>
<tr>
<td>51 - 55</td>
<td>2.99</td>
<td>3.73</td>
<td>4.95</td>
<td>5.21</td>
</tr>
<tr>
<td>56 - 60</td>
<td>2.29</td>
<td>2.32</td>
<td>4.39</td>
<td>4.75</td>
</tr>
<tr>
<td>61 - 65</td>
<td>2.72</td>
<td>3.23</td>
<td>4.59</td>
<td>5.01</td>
</tr>
<tr>
<td>66 - 70</td>
<td>3.51</td>
<td>3.69</td>
<td>4.95</td>
<td>5.21</td>
</tr>
<tr>
<td>71 - 75</td>
<td>3.02</td>
<td>3.20</td>
<td>4.51</td>
<td>4.99</td>
</tr>
<tr>
<td>76 - 80</td>
<td>3.00</td>
<td>3.20</td>
<td>4.51</td>
<td>4.99</td>
</tr>
<tr>
<td>81 - 85</td>
<td>2.87</td>
<td>3.14</td>
<td>4.71</td>
<td>5.15</td>
</tr>
<tr>
<td>86 - 90</td>
<td>2.94</td>
<td>3.06</td>
<td>5.46</td>
<td>5.79</td>
</tr>
<tr>
<td>91 - 95</td>
<td>3.52</td>
<td>3.67</td>
<td></td>
<td></td>
</tr>
<tr>
<td>96 - 100</td>
<td>3.96</td>
<td>4.61</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>All</strong></td>
<td><strong>2.98</strong></td>
<td><strong>3.14</strong></td>
<td><strong>4.53</strong></td>
<td><strong>4.97</strong></td>
</tr>
</tbody>
</table>

Source: Moneyfacts

In a stable interest rate environment, it is easy to see how firms will be able to compare current and future interest rates and monthly payments. However, if interest rates are falling it will be more
difficult, especially if a rate change is imminent. It might not be clear if the rate offered today would be the best rate in the near future.

In a rising interest rate environment, customers coming off a fixed rate may find that all new mortgages are written at higher interest rates and lenders will not be able to use relative affordability as true assessment of a customer’s ability to pay.

There is a trade-off between lower interest rates and long term certainty for customers. The rising number of customers taking out a five year fixed rate mortgage suggests that for many people the certainty of the amount that they have to pay is of more value to them than a slightly lower interest rate. An unintended consequence of concentration on price may be that customers are incentivised to take out shorter term fixed rates, forsaking longer term price stability.

Only those customers who have been on an SVR or reversion rate for more than 12 months will be able to take advantage of the new relative affordability assessment. In most circumstances a customer coming off a fixed rate will not be able to move to a new fixed rate mortgage using the new affordability model. This is because the customer would not have been able to demonstrate that they can pay the new rate. Unless they can find a new fixed rate lower/cheaper than their current fixed rate they will have to go through the full affordability assessment.

New Product Availability

TPAs that service the closed book customers have stated that there will be a need for products to be available before customers are written to and advice is given. If customers are contacted before the new products are available and intermediaries are ready to provide advice, the customers are likely to be told that there is nothing available for them, become disengaged or complain to the TPA when it is not their fault.

It is also important that there be a range of products available as the customers will have different characteristics and one size will not fit all. While some firms will develop new products, others will adapt existing products, but as has been seen from the recent regulatory changes introducing retirement interest only mortgages (RIOs), it can take a long time before the rules are amended and a critical mass of suitable products becomes available.

We note that many commentators are asking for the proposed changes to be implemented quickly. However, lenders will not be in a position to offer new products until they have changed their underwriting systems and process to capture, assess and record the different affordability data required to conduct a modified affordability assessment. Staff in broker firms and lenders will need to be trained in how the new affordability assessments will be implemented. Lenders and UK Finance believe that a joint implementation working group would be helpful in assisting lenders to prepare products following the changes to the rules and work towards a common launch date so that there is a range of products available to customers.

Securitisation

Lenders are still analysing the impact of this proposal on future use as collateral, securitisation etc. If this process creates a material downgrading of their assets in the eyes of ratings agencies this could significantly reduce participation. Some lenders are concerned that using the new affordability assessment may impact the securitisation of the mortgages. At present different books within the same lender are held separately either because of securitisation or a purchased closed book. To move a customer from one book to another would cause a new regulated mortgage contract (“RMC”) to be created and therefore the full affordability assessment which is why some lenders cannot do this currently. It is not clear whether the proposals in the consultation paper can be applied to existing customers of closed books where the owner also has an active book.
Q1: Do you agree that our proposals should only apply to firms dealing with consumers that meet the conditions of ‘eligible consumers’?

Yes, this is a reasonable group of customers to include in the scheme. We think that some customers will benefit from the ability to re-mortgage, but it will be important to manage the expectations of all stakeholders, including the customers of closed book lenders.

The inclusion of both first and second charge mortgages within the new affordability assessment should enable some customers to benefit from lower rates as consolidating a second charge should be cheaper. However, there is also a concern that a customer with affordability issues and looking for additional lending could result in customers taking out a more expensive second charge mortgage rather than take out a larger first charge mortgage under the full affordability assessment.

It is well known that in the run up to the financial crash of 2007/08, a number of lenders were writing new mortgage business on a self-certified or fast track basis, often at high LTVs. In addition, the FCA’s “Dear CEO” from March 2018, drew the attention of second charge lenders to the need for responsible lending. This found that many lenders were not undertaking full affordability assessments (for example “income and expenditure calculations sometimes produced disposable income figures that didn’t seem plausible when taking into account an applicant’s credit profile”). Therefore, there is some concern that the full financial position of the borrower may not be apparent unless there is a full affordability assessment in every case.

Lenders have stated that they would find it helpful to have guidance on how they should evidence the amount outstanding. There will also be difficulties proving there are no arrears if there are no credit checks undertaken. Clarity would also be appreciated on whether and if so how lenders are to take into account situations where borrowers have had payment holidays within the last 12 months. In many cases such payment holidays may have been “earned” as a result of previous overpayments, whereas in other cases they might reflect forbearance on the part of the lender and therefore provide an indication of a customer in financial difficulty.

We require clarity from the FCA relating to the definition of 12 months. For example, could a customer make an application at month 10 and be approved based on their payment history but drawdown not allowed until 12 months have been paid at the higher rate? The approval would be conditional on the consumer making the two later payments. There are customers who have made overpayments who then take a payment holiday while their account returns to scheduled payments. While there are few customers in this position, they should not be prevented from moving to a better rate through a relative affordability assessment.

We are also unclear whether a customer has to be on a higher “reversion rate” for 12 months before they are eligible to switch. For example, if the customers has been on a fixed rate mortgage paying £1300 for 24 months and then goes onto a reversion rate of £1600 for two months, is that sufficient proof they could pay a new fixed rate of £1350 per month? Or would the lender have to see 12 months payments at £1600?

At the same time, there are groups of customers within the definition who are unlikely be able to move a new lender. These include:

- customers who have accrued fees and charges which they cannot afford to repay. The definition of not wanting to borrow more means that fees and charges, which may have been accrued during a period of arrears cannot be capitalised. The current lender will not allow a mortgage to be redeemed while there are fees outstanding. And the customer may not be able to afford to pay them off in one instalment. An unintended consequence could be some customers using more expensive credit such as credit cards to clear fees. Some lenders believe that reasonable outstanding charges could be capitalised and customers able
to transfer to a cheaper mortgage e.g. by extending the term. We believe this could assist some closed book customers but without data from the TPAs we are unable to quantify this number;

- customers for whom the lender has had to pay the ground rent, this being an indication of a customer in financial difficulty;
- customers who are in negative equity or have high LTVs – over 90 or 95%. High LTV products may be available but at a higher price, so little or no savings will be available to customers;
- most lenders (and brokers) will not lend (or advise) on low value property, for example those with a value of less than £50,000;
- some customers with poor credit records may not be able to get a more affordable mortgage. The risk profile they present would probably mean that any new mortgage, with additional arrangement fees added to the balance, will be more expensive than remaining on their currently reversion rate.
- customers who have a short period of time left on their mortgage – most lenders will be looking for a minimum of three to five years remaining as there is a cost in taking on a new customer; and
- customers who have a small balance remaining – the cost of taking on a new customer is much larger than transferring an existing customer to a new rate, so lenders will require a larger balance to transfer. Lenders are considering how much will be needed, but it is expected to be at least £25,000.

It must also be made clear in FCA guidance that only residential mortgages (i.e. not buy to let, holiday home or other commercial mortgages) should be included. Some lenders will also exclude properties that have consent to let in line with their general lending policies. We understand that firms will be able to use the new affordability assessment for Consumer Buy to Let mortgages and would like to see this confirmed in guidance.

We are aware that consumer advocacy groups are suggesting that customers in arrears should be included in the definition of eligible customers. If the amount in arrears and any charges accrued are added to the mortgage the customer will be borrowing more and need a full affordability assessment. If a customer is in arrears their risk profile means that they are likely to have to pay a high new rate and so there is little likelihood of them making a saving. We also note that government guarantees are highly bureaucratic and have not been taken up in great numbers.

We think it is right that if customers including first time buyers want any new borrowing, further advances or debt consolidation they will need a full affordability assessment. In addition, changing the names on the mortgages should require a full affordability assessment as household income is likely to have changed significantly.

For those whom the proposals will not help it will be up to the UK government to work with the FCA on full regulatory protections and fair treatment for the many thousands of customers with inactive lenders or unregulated owners, who either cannot or will not move.

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?

This seems a sensible definition at first glance but is quite complex. Getting confirmation of payment status could be difficult without undertaking a range of credit checks. Lenders will need to ensure that customers do not have other debts or attributes which would make them an unacceptable credit risk to that firm. Therefore, most lenders would apply a credit check to all customers as part of the on-boarding process.

For lenders that price to risk, if the customer has a poor credit record, they may be offered a more expensive mortgage rate to reflect the additional risk the lender is taking on. If lenders do not price
to risk, the more likely outcome for customers who have a poor credit record is that they will be declined and a more expensive credit impaired (or low credit score) mortgage will be offered, as this will not be cheaper if the full MCOB 11 rules are applied.

Lenders are subject to other regulatory and reporting requirements e.g. MLAR definition and reporting requirements for Impaired Credit History – SUP16-19 E3.1 and European Central Bank Guidance on Unlikeliness to Pay indicators, which may have an impact on the definitions used.

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?

The more complex the processes are for the consumer, the more likely it is that poor customer outcomes happen. If the consumer does not understand the product being recommended for them then s/he cannot make a rational decision whether to buy it.

We think that the relative affordability assessment should be based on the total amount that the customer will pay over the deal period for fixed rate mortgages, or the total repayable over the full term for variable rate mortgages, compared to what they would have paid if they had remained on their existing mortgage(s). This will make it simpler to compare multi-part loans and loans with different terms. It also makes the comparison of relative interest rates unnecessary.

The two models proposed are complex, and the calculation is different for with and without fees. We do not think that the fees, where paid upfront, should be included in the calculation of cost. This would effectively simplify the calculations.

The customer has to positively elect to add fees to the loan (MCOB 4.6A) and the fact is disclosed on the illustration (MCOB 5.6.18). To date, the Handbook has not required advisers or lenders to include fees paid up front in cost calculations. We cannot identify a harm that is trying to be prevented by including fees paid up front in the calculations.

The proposed rules might incentivise customers to add arrangement fees to the mortgage even though this may result in customers paying more overall. i.e. the requirement to compare the total cost over the incentivised deal period (in cases where arrangement fees are being paid up front) is potentially slightly more onerous, and more complicated for customers to compute) than comparing monthly payments (as in cases where arrangement fees are added to the mortgage).

Given the FCA’s keenness to make sure customers are given appropriate advice on the impact of adding arrangement fees to mortgages, it seems odd that it has proposed not to insist on any additional disclosure.

Lenders have confirmed that it is difficult to arrange a remortgage which is for a sum exactly matching the outstanding loan as this is influenced by a number of factors, e.g. date of redemption and any closure fees including potential early redemption charges (“ERCs”). Credit bureaux, where available will only show a capital balance. This needs to be reflected in the final wording of the rules.

If lenders’ arrangement fees can be added to the loan, then it is logical that a broker’s fee can also be added.

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 categorically do not think the standard variable rate (“SVR”) or revision rate at the end of a fixed rate is a legitimate comparison. Lenders have described this requirement as “belt and braces” as
the other measures proposed will ensure that borrowers have the protections they need, particularly
given the requirement for a lender to have a policy of offering a new mortgage at the end of any fixed rate period.

If this change in policy is designed to engender a switching culture, such that consumers who have
availed of this process having overcome the initial inertia will be much more proactive in future
switching then a whole of loan life comparison becomes less compelling.

The proposed definition in section 3.15 is problematic as it could result in a price cap on reversion rates and as such reduce customer choice. Lenders whose business model requires a higher than market average reversion rate will not be able to offer products under the revised affordability assessment, even though the fixed rate and product features would make the product suitable for customer’s circumstances. This in turn could create further advantages for larger firms, and as a result reduce competition and consumer choice. It would also introduce an additional complexity for customers and mortgage professionals, without additional benefit.

This also creates a scenario where customers who go through a full affordability assessment do not
have the same protections as these customers - so it appears to create an uneven playing field with implications for the fair treatment of customers.

Lenders and other commentators have noted it is normal behaviour for consumers to consider the monthly payment over the long-term cost of the loan. For example, in “Understanding consumer expectations of the mortgage sales process”, a research report commissioned by the FCA from ESRO1, the researchers found:

“This consumers are primarily concerned with the amount they will be paying each month as this will affect their monthly finances, and lifestyle. The majority of consumers have a target monthly repayment amount in mind during their mortgage research. This is usually based on previous mortgage repayment amounts, or rental payments for First Time Buyers. A ‘good deal’ for consumers is perceived to be a mortgage with an initial monthly repayment which meets this target amount.”

“Many [consumers] express a desire for stability in their mortgage, and therefore a preference for fixed rate products, but go on to choose a two year deal to achieve a cheaper monthly repayment amount,”

If this rule were introduced customers of the lender with the lowest SVR would not be able to move to a better fixed term deal, even if the fixed rate were lower than the reversion rate. This is a particular restriction for some types of lender where the reversion rate is higher even though the borrower will be offered a new product before the end of the fixed term,

Given the funding structures used by smaller lenders there is a clear implication that the market will be smaller if the existing and reversion rates are used to determine whether the new mortgage is more affordable.

This model may not work in a different economic environment for example if interest rates are rising or general funding costs rise, and reversion rates are higher as a result.

In determining whether the new mortgage is more affordable, the use of the reversionary rate would inhibit movement in the market.

---

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

We welcome the flexibility but note that it will be down to the lender’s risk appetite as to whether they want to extend the term.

If a customer asks a firm to extend the term of the mortgage to make it more affordable, or if the adviser suggests extending the term to reduce costs to the customer, is this an indication that the current payment is unaffordable? If so, some lenders suggest that consumers wanting to extend the term of the mortgage should sit within the advice process.

Of course, a term extension may not necessarily be a sign that the mortgage is unaffordable, if it is in the context of a customer wishing to switch from an interest only mortgage (IO) to capital and interest (C&I) repayment or a part and part mortgage. Having said that, term extensions will not be a panacea for closed book customers on IO, who are likely to be closer to retirement and unlikely to be able to manage the length of term extension needed to switch from IO to C&I without going into retirement.

Over the extended period of the mortgage, the customer is likely to pay more in interest than they would have done if the mortgage were repaid over the original term. The FOS has stated that if customers pay additional interest over the term of a loan this may not be considered fair.

Advisers will have to determine if extending the term of the mortgage is in the best interests of the customer and will need guidance to assist them with this. Firms will have to decide whether to allow customers to extend on an execution only basis.

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, if the intention of the policy is to encourage switching behaviour, then lenders must offer their customers an opportunity to move to a new rate at the end of the introductory period. However, there will be the need to retain the “small print” in consumer contracts detailing the abnormal circumstances in which that might not be possible e.g. if the lender becomes inactive. We believe it would be helpful to clarify in the guidance that this requirement is to offer one or more of their own products to their existing customers and not just to allow them to transfer away.

As noted in the Mortgage Market Study Final Report the vast majority of customers are now able to switch to a better deal with their existing lender as a result of the Industry Voluntary Arrangement.

There is evidence from product transfer data that there is a high level of switching at the end of a fixed term. The proposals set out in CP 19/17 are also likely to support this trend further.

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)?

Every firm will have its own risk appetite and so different firms may choose to disapply different elements of the affordability assessment. We believe that if customers have recently taken out loans or credit arrangements (e.g. credit card with an initial bonus rate which increases after a period of time / personal loan which may not have started) this may impact their future affordability. Therefore, customers who are on the cusp of payment difficulties, but currently present a clear payment record may fall into arrears quickly after moving lenders. As a result, income will still have to be verified and factors such as the permanency or otherwise of contracts/working
arrangements.  Self-employed customers may need additional assessment to ensure self-employed income remains consistent and is not declining, for example.

Mortgage lenders are required by law to check a new customer’s identity to prevent money laundering and fraud. Customers will need to produce documents to prove their identity and address and information on their source of funds. Checking this information is a legal requirement to help safeguard the transaction and failing to check ID documents could result in lenders breaching anti-money laundering legislation. Lenders will require the new customer to provide:

- proof of identity - passport, driving licence, EEA member state identity card; and
- proof of address - driving licence, bank or credit card statement, utility bill (not more than 3 months old).

In addition, to prevent fraud lenders will require new borrowers to provide proof of source of funds for example at least the customer’s last three months’ payslips; P60 form from their employer(s); tax return and other documents if the customer is self-employed.

Income verification is also required if the mortgage is to qualify under the STS (Simple, Transparent, and Standardised) Securitisation scheme and the lender intends to securitise its book.

Therefore, removing the income verification requirement from the FCA handbook will not stop lenders needing to examine how a new customer will make payments on their mortgage. Likewise, lenders are still likely to consider change in circumstances (MCOB 11.6.14R) for customers and therefore in practice few lenders may disapply this.

Lenders have expressed a general concern that changes to affordability assessment may lead to Claims Management Companies suggesting disallowing parts of the current assessment could be classed as irresponsible lending. It would be helpful if the FCA could set out the logic as to why applying the proposed affordability assessment is regarded as responsible lending. The FCA should also obtain agreement from the Financial Ombudsman Service that the application of the new affordability assessment would not be regarded as irresponsible lending.

**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, but it seems incongruous to check affordability into retirement but no other life events. We understand that if the customer is already in retirement the lender will not need to verify how they will pay for their mortgage into the future. It would be helpful if any guidance provided by the FCA could set this out clearly, especially if a customer discloses that they will be having children or are being made redundant, getting divorced etc. In practical terms it is difficult to see how income in retirement will be ascertained without some discussion about current circumstances and that could raise other questions or concerns. There is a significant likelihood that firms will mitigate this risk by not allowing loans to run past retirement by any material length.

Some lenders are concerned that, with the prospect of an economic turndown, not taking into account changes to income or expenditure, such as customers being at risk of losing their jobs or having their hours reduced, could result in more customers on their books being in default.

**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, especially as borrowers would have been paying more with their existing mortgage.
Lenders have noted that while the original mortgage payments were higher, the new rate may not be a full percentage point lower. In a time of low interest rates this might not be an issue, but in a rising or higher rate environment lenders will want to ensure that customers could tolerate a price shock. Some lenders, therefore, may choose to apply a modest stress test, and this will need to reflect the interest rate environment with higher rates being applied if interest rates are increasing.

Firms are also concerned that while conduct risk is removed with the removal of the FCA’s stress test the FPC could change its policy on stress testing if they believe interest rates will rise.

Given the recent warnings about riskier lending in a low margin environment by the PRA, lenders are concerned that regulators are pulling in different directions.

**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?

Allowing lenders some flexibility is welcomed and pragmatic, but lenders should be required to set out in their responsible lending policy how they mitigate this particular risk.

Lenders believe there is an increased risk if they do not consider future interest rate rises, specifically if interest rates increase or customers take tracker rates and rates increase. If the customer was paying one percentage point higher in interest than the rate they have now re-mortgaged to, it would be a risk to assume they can also maintain a rate increase of 2-3 percentage points, so at what point should lenders consider future interest rate rises and at what point should they rely on past payments to mitigate the risk for the customer and the lender?

We suggest a minor drafting proposal that the interest rate should be “the same as, or lower than” the rate the customer is on.

**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?

Lenders have stated that they would not be prepared to accept a new mortgage on an interest only basis where a customer does not have a credible repayment strategy in place.

According to FCA data, the 2027 and 2032 peaks of interest only customers includes fewer affluent individuals with higher income multiples and less equity.

Accepting interest only customers who have no credible repayment strategy in place may mean that they are paying a lower rate of interest, but it would not improve their long term position. In addition, acceptance of this type of lending may give the perception that lenders believe this to be an acceptable position for the customers to be in, which would not be the case. Lenders would then have to find solutions to help customers to repay the mortgage at the end of the mortgage term and possibly be open to mis-selling complaints or scrutiny around the decision to lend in this scenario.

We are aware that mortgage indemnity guarantee (MIG) providers do not want to accept people onto this new method of assessing affordability.

We believe that interest only customers have a range of characteristics that may make them more or less attractive to a new lender. For example:

• lower LTV, older customers with a regular income may be suitable for a RIO mortgage;
• it is unlikely that lenders will want to take on IO customers who do not have a credible repayment strategy – therefore they will want to establish how they will get any capital outstanding at the end of the mortgage term is repaid;
• some firms do not allow new IO borrowing and those still active normally have additional criteria which apply (e.g. minimum income, lower maximum LTV), which would reduce the pool of eligible customers; and
• younger borrowers who are more likely to be able to convert to a capital and interest/repayment mortgage may require additional advice and will probably end up paying more. Some firms may be willing to take on such customers with the aim of moving them to a full repayment mortgage over a longer term, but this will need a full affordability assessment.

We have also considered whether a customer could move from an IO to a repayment mortgage. The analysis we have undertaken suggests that very few customers would be able to move to a new mortgage on the same monthly repayment.

**Interest Only to Capital & Interest Assessment**

| Mortgage Balance Outstanding | £160,000 | £75,000 | £160,000 | £75,000 | £160,000 |
| Current Mortgage Rate         | 4.73%    | 4.95%   | 4.73%    | 4.95%   | 4.73%    |
| Current Monthly Instalment (CMI) - IO | £630.67 | £309.38 | £630.67 | £309.38 | £630.67 |
| Current Borrower Age (years)  | 41       | 58      | 41       | 58      | 41       |
| Maximum Product Loan Term (years) | 40     | 40      | 40       | 40      | 40       |
| Maximum Age at Maturity (years) | 70     | 70      | 70       | 70      | 70       |
| New Mortgage Rate             | 3.69%    | 3.69%   | 3.00%    | 3.00%   | 2.30%    |
| New Loan Term (years)         | 29       | 12      | 29       | 12      | 29       |
| New CMI as Capital & Interest | £749.47  | £645.42 | £688.95  | £620.84 | £630.45  |
| Ratio of New Payment vs Old Payment | 118.84% | 208.62% | 109.24%  | 200.68% | 99.97%   |

These figures show that for a capital and interest mortgage to be at the same monthly payment rate as the Interest Only the customer would have to take out a very long mortgage.

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

Most lenders believe that customers moving home will have significant changes to their income and expenditure including transport costs, council tax rates and minor home improvements.

Most lender would prefer to see the new rules for customers who are not moving embedded before allowing a further relaxation of affordability assessments, but a minority believe that as long as the debt and LTV are the same then the new affordability assessment could be applied.

**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?**

Yes, where a closed book owner is unregulated the FCA cannot instruct them to contact their customers. TPAs need to be instructed by the FCA to contact those customers. There may well be contractual implications for the TPA in terms of the use of customer data and whether the TPA has the authority from the unregulated entity (as data controller) to process customer data in this way.
We understand that the FCA expects a one letter approach, but is this a one-off contact, or will the FCA expect TPAs to periodically review their books and write to newly eligible customers? TPAs would like to have clarification of the FCAs expectations.

We understand that TPAs can send out the letters as soon as required, but the key issue is lenders having products available. TPAs have the ability to segment their customers into smaller tranches (e.g. capital and interest repayments, interest only, both customers over retirement age etc), but for this to be useful they will need to have basic eligibility criteria for different mortgage products e.g. RIO, capital and repayment etc.

TPAs have concerns that if letters are sent out before products are available or to customers for whom at the time there is no suitable product in the market (e.g. on an IO mortgage with no repayment strategy) this is going to result in unrealistic consumer expectations and drive customer complaints to the current lender/TPA when their expectations are not met.

It is our understanding that this proposed requirement applies to firms acting as Principal administrator for an unauthorised firm and not where a firm is acting as other administrator, as defined in MLAR guidance as:

“Other administrator”: this is where your firm (although authorised to undertake a mortgage Administrator's activity) is undertaking loan administration for either a lender or other firm which itself is also authorised to undertake a mortgage administrator's activity. In this situation, your firm is not regarded as the ‘principal administrator’, and you are merely acting on behalf of an authorised mortgage administrator

**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?**

We think that to prevent people having unrealistic expectations about moving to a new lender, there needs to be some filtering of the customers in closed books. If customers who are unlikely to get a new mortgage are written to, this exercise will result in additional (unresolvable) complaints against TPAs, brokers and lenders.

The cost benefit analysis attached to the consultation paper estimates that 500,000 closed book customers will be written to, but this will include people who currently are on a low reversion rate e.g. on a low LIBOR linked tracker, have a small balance, have a short remaining term or an interest only mortgage.

People who should be excluded from customer contact strategies include those who:

- have lifetime mortgages;
- have consent to let;
- have non-residential mortgages;
- have very low interest rates (e.g. on LIBOR trackers)
- are not up-to-date with payments or have been in arrears in the past 12 months
- are in receipt of SMI
- have a debt management plan in place
- have a low value property (e.g. under £50,000)
- have a low balance (e.g. under £25,000)
- have a short term remaining (e.g. under 3 years) or
- have an IO mortgage with no credible repayment strategy recorded with the lender.
The proposed wording in the new handbook rules at 11.9.14 (5) - “another lender may now only choose to check whether you have been up to date with your mortgage payments over the last 12 months” does not accurately reflect the range of other checks firms will have to execute. The currently proposed wording could result in lenders (and TPAs) receiving complaints because the potential customer thinks that only their repayments will be assessed.

Any communications with customers of closed books must be in plain English and reflect what firms are likely to consider when determining if a customer may be suitable for a new deal. It would be useful to discuss the proposed wording of the customer communications with lenders, TPA and brokers as well as their representatives.

**To assist customers to determine whether they may qualify for a lower rate mortgage, a predictor tool, hosted on an independent website such as the Money and Pensions Service would be useful.**

This could be developed through an FCA competition by FinTechs.

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

Firms accept that the additional disclosure will give them evidential proof that the consumer has been given all the information they need. This will be important if the transfer is undertaken on an execution only basis. Lenders would like the FCA to provide examples of good practice of this type of disclosure.

However, firms are concerned that if the customer has already been given advice, this additional disclosure could be confusing and even put people off if they are told that the mortgage could cost more money.

Instead, this information should be disclosed at the time of application and interview with the customer, prior to recommendation and as part of assessment of suitability. This information is of no real value at time of offer – as it is probably too late at this stage to advise customers of these facts and it may deter some customers in proceeding with the mortgage.

It may be appropriate to inform the customer (either in a disclosure or at some other part of the journey) that post completion changes which alter the credit risk would need to be fully affordability assessed especially if they have ERCs to take into account.

We think that an additional disclosure may be appropriate. Customers coming off an SVR will not have any restrictions in terms of early repayment charges, etc. However, the relative affordability assessment may restrict a lenders capability to perform contract variations, such as further lending, transfers of equity, etc, as the full responsible lending rules will need to be applied.

If the lender sets out how their affordability assessment has been carried out in too much detail, there is a higher risk of fraud.

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

Yes, but as stated in previous submissions, any changes to data collection should be coordinated to keep lenders costs and systems disruptions to a minimum. The new reporting requirements are likely to require lenders/TPAs to create new data fields within their administration systems in order to capture the data to be reported, and time will need to be allowed for implementation of the new reporting requirements.
We would ask that the FCA is mindful of its changes to regulatory reporting under CP18/41: FCA and PRA changes to mortgage reporting requirements. It would be helpful for firms to consolidate all changes to regulatory reporting into one date for delivery.

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, that is sensible.

Should you have any questions about the content of this paper please contact Sue Rossiter (sue.rossiter@ukfinance.org.uk).