



House of Commons  
Treasury Committee

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**Mortgage arrears and  
access to mortgage  
finance: Government  
and Financial Services  
Authority responses to  
the Fifteenth Report  
from the Committee**

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**Tenth Special Report of Session  
2008–09**

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## Tenth Special Report

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The Treasury Committee published its Fifteenth Report of Session 2008–09, *Mortgage arrears and access to mortgage finance*, on 8 August 2009, as House of Commons Paper No. 766. The Government and the Financial Services Authority responses to this report were received on 19 October 2009 and are appended below.

The responses from the Government and the Financial Services Authority are in plain text and the Committee's conclusions and recommendations are in bold text.

### Appendix 1: Government response

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The Government welcomes the Treasury Select Committee's report *Mortgage arrears and access to mortgage finance*, published on 8 August this year, which makes an important contribution to the debate on mortgage repossessions.

The Government is committed to supporting stable and efficient mortgage markets that are fair for consumers. It remains determined to take all appropriate steps to ensure that lenders lend responsibly, mortgage borrowers are protected and there is a range of support and advice for those facing financial difficulties. The Government has put in place a strong framework of protection for borrowers in support of these objectives. In 2004, the Government introduced legislation to extend the scope of Financial Services Authority (FSA) regulation to include first-charge residential mortgages. The FSA's regime provides important protections, including requirements that lenders treat customers fairly and consider repossession only as a last resort.

In the Turner Review of financial services, published in March 2009, the FSA announced its intention to publish a discussion paper on its regulatory regime for mortgages. The FSA has published its mortgage market review today and is submitting this to the Treasury Select Committee (TSC) separately alongside a detailed response to the TSC on the recommendations of the report that are directly addressed by its regime. The FSA will update its rules on repossessions, while continuing with a programme of proactive enforcement action to ensure that lenders comply with its rules. Its discussion paper also proposes a wider package of reforms in order to lay the foundations for a market that works better for lenders and consumers over the long term.

The FSA has made clear that it continues to regard the fair treatment of borrowers in arrears as a priority through the recession. The Government welcomes the FSA's continuing focus on arrears and repossessions at this time. It expects all lenders to comply fully with their regulatory obligations.

The Government has established a Lending Panel to monitor lending to household and business. As part of this approach the Home Finance Forum, chaired by Paul Myners, the Financial Services Secretary to the Treasury, brings together lenders, trade associations, consumers and debt advice groups to monitor mortgage markets and encourage best

practice. The lenders on the Home Finance Forum are committed to supporting borrowers facing difficulties and always only repossessing as a last resort.

The Government is committed to ensuring that high quality debt advice is available for borrowers who need it. Since April 2006, the Government has invested over £130m in a face-to-face money advice project aimed at the most vulnerable households. So far, the project has helped over 245,000 people with their debt problems. At the 2009 Pre-Budget Report, the Government increased spending on debt advice, including a further £5.85 million for National Debtline between November 2008 and March 2011, to increase provision of free telephone debt advice

Universal protection for borrowers from FSA regulation and the courts is supported by a number of Government schemes providing targeted help to specific groups of homeowners. For those who need direct assistance, the Government is helping through Support for Mortgage Interest. For those who have exhausted all other options, the Government has introduced the Mortgage Rescue Scheme and Homeowners Mortgage Support. Around 300,000 households have received help and advice in connection with their mortgage payments since April 2008.

This action is making a difference—as reflected by the decision of the Council of Mortgage Lenders revising down its forecast for repossession for this year, from 75,000 to 65,000. Whilst not all borrowers have felt the benefit of reduced rates, the average mortgage interest rate, as published by the Bank of England, has fallen from 5.79 per cent in August 2008 to 3.58 per cent in August 2009.

On 8 September the Government launched a new national campaign to help struggling homeowners take control of their finances and make the most of the support available for them to avoid repossessions and stay in their homes. Concerned homeowners will be able to go to [www.direct.gov.uk/mortgagehelp](http://www.direct.gov.uk/mortgagehelp), or contact the National Debtline on 0808 808 4000 for impartial advice, real life examples of people who have already benefited from support, and to develop a personal action plan tailored to their particular circumstances.

## Mortgage arrears and repossession levels

**Being in arrears and facing the threat of repossession are distressing experiences. The evidence we have reviewed shows that both mortgage arrears and repossession levels are on an upward trend, which is expected to continue in the next few years. As recent global events have shown, the fortunes of economies are intimately bound up with that of their housing markets. (Paragraph 14)**

**Much uncertainty remains as to whether any recovery in the housing market would mitigate or exacerbate the scale of repossession. We recommend that the FSA monitors the forbearance policies of mortgage lenders to ensure that repossession is only a tool of last resort. (Paragraph 19)**

**We share the concerns expressed by groups such as Shelter, Which? and Citizens Advice that the FSA's principles-based approach in the area of mortgage arrears has given far too much flexibility to lenders to interpret the rules as they wish. The consequence has been a wide divergence in practice amongst firms with consumers treated in an inconsistent manner and little way of establishing whether they are being**

treated fairly. We agree with the Financial Services Consumer Panel that there is an urgent need for more rules or a more explicit statement of the requirements on firms in guidance to help put some 'grit into the system'. We note the arguments put forward by the industry that the FSA's high-level principles in this area are complemented by more practical industry guidance, but believe the need for industry guidance in this area actually illustrates the deficiencies of the FSA's current approach. Industry guidelines are not a substitute for more robust rules—they are voluntary not binding, there is often little monitoring or supervision and there are no sanctions for non-compliance. (Paragraph 47)

We note that the FSA has begun moving from a principles to an outcomes-based approach and trust the FSA's Mortgage Market Review, which includes a re-examination of the mortgage conduct of business rules, will lead to a shift in this direction with a better balance between high-level principles and rules that are binding upon firms. The FSA's Mortgage Market Review must also give serious consideration as to whether the mortgage conduct of business rules need revising. The rules were drawn up in the early part of this decade in a very different economic environment and there is concern, expressed by the Financial Services Consumer Panel amongst others, that revisions need to be made to ensure the rules are appropriate for the very different economic circumstance prevailing today. (Paragraph 48)

FSA regulation of first charge residential mortgages requires lenders to consider repossession as a last resort. The FSA continues to stress that it regards lenders' treatment of borrowers in arrears as a priority and the mortgage industry as a whole can expect continued intensive scrutiny of its arrears handling processes.

The FSA has published today its mortgage market review, which considers detailed changes to its current rules governing lenders' treatment of borrowers in arrears and facing repossession. The Government has asked the FSA to respond to the TSC on the detail of its regime.

## The regulatory framework

We believe that the issue of the regulation of second charge mortgages should be reviewed by the Government. This Report focuses mainly on the principles and rules relating to first mortgages regulated by the FSA and it would be a cause for concern if second mortgages (likely to be taken out by those with greater needs) were less well regulated. (Paragraph 22)

Apart from first-charge mortgages, all consumer credit business, including second-charge mortgages, is regulated by the Office of Fair Trading (OFT) under consumer credit legislation.

The OFT has recently produced guidance for the second charge sector (in July 2009) which sets out the minimum standards the OFT expects from businesses engaged in second charge lending.

In March this year, the Government announced that it would review the current split of OFT and FSA regulation in relation to second-charge mortgage lending.

On 8 July, the Government published *Reforming Financial Markets*, setting out the Government's proposals for reform of financial services. In this document, the Government announced that it would review the case for transferring regulation of second-charge mortgages to the FSA, and would update by the 2009 Pre-Budget Report.

**The evidence we have received suggests that mainstream lenders are, broadly speaking, complying with the FSA's mortgage conduct of business rules. Indeed, we have heard positive examples of some mainstream lenders taking pro-active steps to support consumers in mortgage difficulties. That said, we are extremely concerned by evidence of a lack of flexibility and forbearance in the sub-prime, specialist and second charge sectors to homeowners in arrears. (Paragraph 32)**

The FSA keeps compliance with its rules under regular review. On 22 June, the FSA published results of a review of lenders' arrears management processes. This review focussed on the processes of specialist lenders and third party administrators. Shortcomings have been identified at a number of the firms investigated, and the FSA has announced enforcement action against individual firms.

The FSA has published today its mortgage market review which considers specific changes to its rules in respect of specialist lending. The Government has asked the FSA to respond to the TSC on the detail of its proposed changes to its regime and its continuing programme of enforcement action in this area.

**We share the serious concern expressed by many of our witnesses that some lenders are charging high and excessive mortgage arrears fees to customers who fall into mortgage difficulties. Whilst we have not received conclusive evidence that the mortgage arrears charges levied by lenders are excessive and go beyond recouping additional administrative costs, we fear that some lenders are using arrears charges as an alternative profit stream. Indeed, the wide variation in the level of mortgage arrears charges levied by different firms adds weight to such a view. (Paragraph 39)**

**Such practices are intolerable, placing additional strain on homeowners already struggling to keep up with their mortgage payments. We note that the FSA has already referred four mortgage firms to enforcement action and understand that part of the case against some of these firms is based on excessive mortgage arrears charges. We suspect these cases represent the tip of the iceberg and call upon the FSA to take a much more robust stance towards tackling and eliminating unfair arrears charges. As a first step we believe lenders must be required to provide an itemised breakdown of the additional costs their arrears charges are supposed to cover. This would help shed valuable light on whether such charges are reasonable and justifiable as industry representatives claimed was the case amongst mainstream lenders. Alongside this, we believe that the FSA and OFT respectively should review all mortgage arrears charges made by mortgage providers and secured lenders to determine whether they are reasonable. (Paragraph 40)**

The FSA's mortgage market review proposes further rules and enforcement action in respect of arrears charges. The Government has asked the FSA to respond to the TSC on the detail of its regime and its enforcement action in this area.

The OFT has recently produced guidance for the second charge sector (in July 2009) which sets out the minimum standards the OFT expects from businesses engaged in second charge lending.

Compliance with the guidance is a relevant consideration for the OFT when determining fitness to hold a consumer credit licence. On the subject of arrears charges, the guidance states 'Any charges on arrears or default should be limited to covering the lender's necessary costs'.

The OFT also has an ongoing investigation into the activities of a number of lenders in the second charge lending sector, focusing on the entire lending process from the initial lending decision up to the handling of arrears and defaults and possession actions.

It is important that the FSA and the OFT continue to work together on these issues which are relevant to both the first and second charge market.

**The FSA stated in its submission said that "in late 2007, we became increasingly concerned by evidence, both from our own mortgage effectiveness review and from external reports by charities such as Citizens Advice and Shelter, that some mortgage lenders were failing to treat their customers fairly when they fell into mortgage arrears'. Yet it was not until June 2009 that the FSA announced that it was finally taking enforcement action against four firms. Furthermore such enforcement action against these firms could potentially take up to a year to conclude. During this period of time, which included the FSA's investigation, over 40,000 more homes were repossessed. The seemingly leisurely approach of the FSA in terms of completing its mortgage arrears review and enforcing possible breaches in the rules in the area of mortgage arrears is a matter of grave concern. We call upon the FSA to spell out clearly in its mortgage market review how it will improve its performance in terms of bringing miscreant firms to book. (Paragraph 52)**

**Currently the FSA only publishes the names of firms it has found guilty of wrongdoing once enforcement action against the firm has been concluded. The industry has told us that it supports the continuance of this approach, although others have argued that this places the interests of lenders ahead of those of consumers. We have concerns that the balance between disclosure to the public and the need to protect firms before they have been found guilty of wrongdoing has tilted too far towards the interests of the industry. (Paragraph 58)**

**Whilst we would not go so far as to describe the FSA's stance on naming firms guilty of wrongdoing as symptomatic of the cosy relationship between the FSA and industry as others have done, we understand why such a suspicion lingers. We were, for instance, surprised that the FSA, in part, justified its decision to reject a freedom of information request in this area on the grounds that publication would damage its relationship with firms who might as a consequence be less willing to provide the FSA with information. Such a softly softly approach contradicts the pronouncements by Hector Sants, Chief Executive of the FSA, who has publicly stated that he wanted firms to be afraid of the regulator. We invite him to add substance to this statement by informing claimants whether or not their cases are being investigated. The impression given at the moment is that it is the FSA that is scared of the firms it is charged with regulating. One possible**

**approach would be for the FSA to publish information on the breadth of practice in the sector which of itself would highlight outliers. (Paragraph 59)**

The Government has asked the FSA to respond to the TSC on the detail of its enforcement programme action in this area.

**The pre-action protocol has been helpful but should be more specific including the giving of examples of unreasonable actions by lenders (for example excessive charging of arrears) which the court may take into account. (Paragraph 63)**

FSA financial services regulation is supported by the pre-action protocol for mortgage possession claims, introduced in November 2008. This sets out clear guidance on what action the courts expect lenders to take before bringing a claim in the courts to help ensure that lenders have tried to discuss and agree other alternatives with the borrower. It is not the role of the pre-action protocol to direct the court as to the reasonableness of lenders' actions.

**We are extremely concerned by the evidence we have received of dubious and unscrupulous practices in the private sale and rent back market. Such practices have caused misery and suffering to many families and have brought the sale and rent back industry into disrepute. (Paragraph 73)**

**We welcome the decision to bring the sector under the regulation of the FSA. However, we have concerns that the interim regulatory regime for the sector—which will be in force until 30 June 2010—may not afford full protection to consumers and may even give some a false sense of security. The FSA must therefore ensure that there will be no slippage in the date for the full regime to come into force and should consider whether this date could be moved forward. We are also surprised that the interim regulations do not contain a requirement for 'independent valuation', despite the fact that the FSA's original proposals in this area contained just such a provision. We seek clarification as to the grounds upon which the FSA made this decision and whether it will include 'independent valuation' as a requirement under the comprehensive regulatory regime which is to be introduced in 2010. (Paragraph 74)**

**There is also a danger that whilst reputable sale and rent back firms will register with the FSA, many others will continue to operate in the 'dark', away from the prying eyes of regulatory scrutiny. The FSA should therefore set out how it intends to register and monitor the activities of those sale and rent back firms and landlords who may try to slip under the radar. At the same time, the FSA must demonstrate that its regulatory regime in this area has real 'bite' and that it will move to enforcement action much more quickly than has hitherto been the case with respect to breaches of its mortgage conduct of business rules. (Paragraph 75)**

On 2 June 2009, the Government laid before Parliament secondary legislation to extend the scope of FSA regulation to include sale and rent back agreements, to strengthen consumer protection in this market. The legislation laid on 2 June includes a two-stage approach to regulation, in order to ensure consumers are protected as quickly as possible in the current market environment.



Following Parliamentary approval, the FSA's interim regime for sale and rent back agreements began on 1 July 2009. The FSA will put in place its full regulatory regime in the second quarter of 2010, following consultation and the publication of its final rules.

The FSA published a consultation on its full regulatory regime for the sale and rent back market on 28 September. The consultation paper is available on the FSA's website, at: [www.fsa.gov.uk/pages/Library/Communication/PR/2009/128.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2009/128.shtml). The consultation period will close on 30 November 2009. The Government has asked the FSA to respond to the TSC on the detail of its regime.

## **Government support for households in mortgage difficulties**

**We welcome the measures which the Government has introduced to support homeowners in mortgage difficulties. However, the need for the introduction of a large number of new initiatives as well as the amendment of schemes in place before the current crisis suggests that adequate safety nets for homeowners in mortgage arrears and/or at risk of repossession were not in place prior to the current recession. We recommend that the Government re-examine its longer-term strategy towards supporting homeowners in mortgage difficulties to ensure that adequate mechanisms to support homeowners are in place even once the current downturn has ended. A part of any review of strategy should be an examination of the adequacy of existing insurance models to protect mortgage holders against adversity and the potential of alternatives. (Paragraph 80)**

**We welcome the introduction of the Homeowners Support Scheme (HMS) which has the potential to provide valuable assistance to homeowners in mortgage difficulties. We recognise that it is too early to make an assessment of how many homeowners have benefited from the scheme and therefore whether HMS can be judged a success. That said, increased disclosure of the details of equivalent schemes operated by some lenders is important, not least so that consumers and advisors have a clearer idea of the support they should be receiving from lenders. Finally, firms representing 20% of the market place are neither in HMS or offering equivalent support to their customers. Whilst there are practical difficulties around securitisation covenants for some in offering such support—something we discuss in greater detail below—the Government must make it a priority to increase participation. Raising participation is especially important as evidence suggests that it is largely sub-prime or specialist lenders who are not participating in such schemes and these are precisely the firms whose customers are most likely to be in mortgage difficulties. Whilst we hope that persuasion will be sufficient to convince more lenders to sign up, the Government should not rule out compulsion if this approach fails. (Paragraph 85)**

The Government is working closely with those lenders who are offering comparable arrangements to Homeowners Mortgage Support (HMS) to ensure that they offer clear advice to consumers about the range of help available.

The Government is committed to securing the widest possible participation in HMS and continues to engage with those lenders who are not signed up to HMS and have not given a commitment to offer comparable arrangements.

**We are concerned by evidence we have received that certain securitisation agreements and covenants may restrict the ability of lenders to offer forbearance and greater flexibility to homeowners in mortgage difficulties and may restrict their ability to participate in HMS. To this end, we call upon the FSA to move quickly to ensure that securitisation agreements already in place do not act as an obstacle to treating consumers in mortgage difficulties fairly. Equally, we would welcome details of how the FSA intends to ensure that future securitisation covenants do not contain such provisions and the timetable to which it is acting. (Paragraph 89)**

The FSA's review of mortgage arrears-handling referred to above examined securitisation covenants, and found that some could lead to unequal treatment of borrowers. The FSA has said that it expects all customers to be treated fairly and to be offered a relevant range of options for resolving arrears. It is not acceptable for a firm to use terms included in a securitisation as justification for not treating customers fairly.

The FSA has also said that it does not expect to see future securitisations that contain provisions that could potentially lead to the less fair treatment of borrowers, for example, by restricting or preventing the use of any commonly available arrears tool where it would achieve the right outcome for customers.

**The Mortgage Rescue Scheme has directly benefited just six households, despite being designed to assist upwards of 6,000 households. We call upon the Treasury and the Department of Communities and Local Government to explain why their projections for participation in the scheme appear to be so out of step with the picture on the ground and request analysis as to whether this reflects flaws in forecasting, poor design of the scheme or lack of consumer demand. We note the comments made by John Healey, Minister for Housing, that MRS has acted as a catalyst for people in mortgage difficulties receiving advice and assistance from lenders and money advisors. This is, of course, to be welcomed, although we do question whether it is the most cost-effective way to raise people's awareness of the need to, in the first instance, work together with their lender to resolve mortgage payment difficulties. (Paragraph 93)**

Recent pipeline data shows strengthened demand for the Mortgage Rescue Scheme. The latest statistics published in August show that as at the end of June, over 300 households had benefited from action to halt court proceedings through the scheme, with a further 454 households in the pipeline.

The Department for Communities and Local Government (CLG) has recently taken steps to strengthen the design/delivery of the scheme. A Mortgage Rescue Scheme fast track team has been put in place, and became fully operational from 1 September. This team is taking referrals directly from lenders to increase volumes and accelerate case processing lead-times. Over 100 referrals have been received from lenders in September.

CLG is working closely with local authorities to further strengthen scheme implementation through the development of LA action plans, scheduled training workshops and support

visits. CLG is also working closely with HCA to deliver a step change in the completing the cases in the pipeline, and to address sector capacity issues through syndication.

**We recommend that the Government should review the Support for Mortgage Interest (SMI) scheme as part of the Pre-Budget Report this autumn, and consider the costs of linking the scheme to either: a contribution-based Jobseekers Allowance or to the tax credits system. As part of that review the Government should examine: the payment of actual interest rates instead of the SMI standard interest rate, the issues surrounding second charge mortgages and what steps would be needed to lift the two year cap on SMI payments. (Paragraph 99)**

The Government introduced a temporary package of Support for Mortgage Interest (SMI) measures in January 2009 to provide extra help to new customers in light of the economic downturn. This included a reduction in the waiting period from 39 to 13 weeks, and an increase in the capital limit from £100,000 to £200,000 for new, some repeat, and some existing customers. Customers who receive contribution-based Jobseekers Allowance (JSA) can receive Support for Mortgage Interest (SMI) after 13 weeks under the new rules, subject to them meeting the other conditions of entitlement to income-based JSA such as the income and capital rules, and whether or not they have a partner who is in remunerative work (work of 24 hours a week or more). SMI can only be paid as part of income-based JSA, but this can be paid on top of, and in addition to, contribution-based JSA. Contribution-based JSA claimants are entitled to a relevant benefit and as such only have to serve a 13 week qualifying period if they come under the new rules.

The Government will keep the SMI scheme under review to ensure that it continues to deliver an appropriate contribution towards reasonable mortgage commitments.

## **Mortgage finance**

**First time buyers face barriers to getting on the property ladder, such as high deposit requirements and restrictive lending criteria. While we are not advocating a return to past levels of lending, it appears that more needs to be done to help credit-worthy first time buyers access credit. It is likely that restricting some first time buyers has negative effects on an already depressed housing market. (Paragraph 113)**

**It is vital that consumers understand that their mortgage payments will vary over time, especially during a period when interest rates are far more likely to go up than to fall. This is the responsibility of lenders and this is a matter that should be enforced by the FSA. (Paragraph 114)**

**We are concerned that decreased competition in the mortgage market could lead to unfair practices towards consumers. The FSA need to be vigilant in their supervision of lenders to prevent anti-competitive practices. (Paragraph 115)**

**Arrears rates in the sub-prime sector are higher than those in the rest of the mortgage market. We note that the current sub-prime arrears rate of 10% is likely to rise given that arrears are predicted to increase. However we acknowledge that there are borrowers who use sub-prime lenders who are able to sustain their mortgage payments. We agree with the FSA that the important issue is for all lenders to consider the affordability of a mortgage for each potential customer. The FSA should ensure that all**

**lenders perform adequate affordability tests, approved by the regulator, and improve their understanding of borrowers' ability to repay. (Paragraph 119)**

The FSA's mortgage market review considers changes to its current detailed rules governing lenders' treatment of customers and assessments of affordability. The Government has asked the FSA to respond to the TSC on the detail of its regime.

Since 1997 the Government has helped more than 110,000 households into homeownership through shared ownership and shared equity. HomeBuy Direct was launched in January 2009 and is helping first-time buyers purchase a new build property from one of the participating developers, with the aid of an equity loan for up to 30% of the property price (up to 15% from both Government and the developer). Budget 09 announced an expansion in the provision for HomeBuy Direct as part of the Kickstart Housing Delivery programme.

Rent to HomeBuy, launched in July 2008, is helping to address difficult market conditions and to assist both first-time buyers and providers by enabling eligible households to rent a new build property at less than market rent (i.e. 80%) for a pre-specified period (up to 5 years), with the first option to buy a share of the property during or at the end of that period under the New Build HomeBuy shared ownership scheme. The households benefit from an affordable rent until they have saved for a deposit and providers receive a rental income in the short term, with a view to a capital receipt later.

*October 2009*

## Appendix 2: Financial Services Authority response

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We welcome the Committee's report on *Mortgage arrears and access to mortgage finance*. In this memorandum we respond to those detailed conclusions and recommendations which are relevant to the FSA.

The mortgage market has worked well for a large number of people over the years and the vast majority of mortgage borrowers will come through this recession meeting their mortgage payments and keeping their homes. However, it has been a cause of major economic distress for others and our existing regulatory framework has proved to be ineffective in constraining particularly risky lending and borrowing. We recognise that our current regime needs to be reformed and aligned with our revised regulatory philosophy. We propose to implement a number of changes to ensure we have a mortgage market that works better for consumers and that is sustainable for all participants. Our proposals are set out in more detail in Discussion Paper 09/03 *Mortgage Market Review* which we published today and is attached.

Our proposed reforms complement our continuing programme to strengthen the overall regulatory regime and represent a significant shift of approach in some areas. They build on our more intensive overall approach to supervision of firms by looking at ways in which we could use prudential and conduct of business levers for macro-prudential and sustainability purposes. They also examine how our supervision can deal robustly with those firms who adopt high-risk strategies, by being prepared to intervene where business models and strategies create undue risks for firms, consumers and the financial system generally. The proposals include, for the first time, provision for regulating and banning specific product charges and a requirement for lenders to assess affordability for all mortgages. They are also based on a greater realism about how consumers behave, including the limitations on the reliance we can place on disclosure requirements as a means of motivating consumers to act in their own best interest.

We are upgrading our monitoring of firms' compliance with mortgage rules and are taking enforcement action where appropriate. This approach operates in tandem with our more intensive and integrated approach to supervision which is designed to help the FSA make earlier and better judgments about the risks that firms and consumers face and mitigate them as part of outcomes-focused regulation.

In response to worsening market conditions we commissioned an urgent thematic review (phase one) of lenders' compliance with our arrears handling rules in December 2007. We then sent a letter to the chief executives of all mortgage lenders and administrators in November 2008 and this was followed by phase two of the review which began in January 2009. Ensuring that lenders treat borrowers in arrears fairly remains a key priority for the FSA and our targeted work on arrears handling is continuing. The actions we have taken to date and further actions we are planning include:

- During the course of both phases of our thematic work we visited 23 firms that account for 60% of the market (based on residential loans outstanding).

- We have referred six specialist lending firms and third party administrators to enforcement for further investigation of evidence of serious arrears handling breaches, unfair charges and for irresponsible lending.
- In January we will issue a Consultation Paper proposing banning some of the unfair charges imposed by firms and to convert our current guidance on forbearance into rules.
- We are currently analysing arrears charges across the industry to understand whether firms are charging more than the administrative costs of managing the arrears. This work has begun and is due to be completed during the second quarter of 2010.
- We will re-visit firms involved in phase two of our thematic work at the end of the year to ensure that improvements firms said they had made to their arrears policies and procedures have actually led to better treatment of customers.
- We are targeting firms with similar business models to the firms currently under investigation and will take action if similar failings are identified.
- We have been working with the Treasury to address the issue of unregulated entities buying distressed mortgage books, with a view to bringing them into the scope of regulation. The Treasury will shortly consult on extending regulation to cover the purchasers of regulated mortgage books.

The principal changes proposed in the *Mortgage Market Review* are:

- banning self-certification loans and requiring income verification for all mortgages (45% of all mortgages in 2007 were approved without proof of income being requested by the lender);
- prescribing the affordability assessments which lenders and intermediaries must make;
- strengthening our arrears rules and banning some of the existing unfair charging practices;
- improving standards of fitness and propriety among individual advisers, and cracking down on rogue individuals by extending our approved person regime to cover several thousand mortgage intermediaries;
- strengthening the disclosure regime by aligning more closely with the approach in both the investment and insurance markets where the focus is on early disclosure of key service information rather than the prescription of the form of that information;
- extending the protection available to customers by signalling our willingness to see our scope extended to cover second-charge lending and buy-to-let. This will be a decision for Treasury; and
- considering whether loans with combinations of risky borrower characteristics should be banned. We have not ruled out loan-to-income or loan-to-value caps in

the future and will open the debate on restrictions on equity withdrawal loans, particularly where consumers already in debt continually remortgage in order to consolidate debts.

Further details on the issues described above are provided in our response below to the specific recommendations and conclusions in the Committee's report.

## **Response to relevant conclusions and recommendations**

**Much uncertainty remains as to whether any recovery in the housing market would mitigate or exacerbate the scale of repossession. We recommend that the FSA monitors the forbearance policies of mortgage lenders to ensure that repossession is only a tool of last resort. (Paragraph 19)**

**The evidence we have received suggests that mainstream lenders are, broadly speaking, complying with the FSA's mortgage conduct of business rules. Indeed, we have heard positive examples of some mainstream lenders taking pro-active steps to support consumers in mortgage difficulties. That said, we are extremely concerned by evidence of a lack of flexibility and forbearance in the sub-prime, specialist and second charge sectors to homeowners in arrears. (Paragraph 32)**

**We share the concerns expressed by groups such as Shelter, Which? and Citizens Advice that the FSA's principles-based approach in the area of mortgage arrears has given far too much flexibility to lenders to interpret the rules as they wish. The consequence has been a wide divergence in practice amongst firms with consumers treated in an inconsistent manner and little way of establishing whether they are being treated fairly. We agree with the Financial Services Consumer Panel that there is an urgent need for more rules or a more explicit statement of the requirements on firms in guidance to help put some 'grit into the system'. We note the arguments put forward by the industry that the FSA's high-level principles in this area are complemented by more practical industry guidance, but believe the need for industry guidance in this area actually illustrates the deficiencies of the FSA's current approach. Industry guidelines are not a substitute for more robust rules—they are voluntary not binding, there is often little monitoring or supervision and there are no sanctions for non-compliance. (Paragraph 47)**

**We note that the FSA has begun moving from a principles to an outcomes-based approach and trust the FSA's Mortgage Market Review, which includes a re-examination of the mortgage conduct of business rules, will lead to a shift in this direction with a better balance between high-level principles and rules that are binding upon firms. The FSA's Mortgage Market Review must also give serious consideration as to whether the mortgage conduct of business rules need revising. The rules were drawn up in the early part of this decade in a very different economic environment and there is concern, expressed by the Financial Services Consumer Panel amongst others, that revisions need to be made to ensure the rules are appropriate for the very different economic circumstance prevailing today. (Paragraph 48)**

## Mortgage arrears and forbearance

Our rules require firms to have regard to the interests of their customers and treat them fairly and specify that repossession should be a last resort. However, while industry guidance in general terms is helpful for the industry as it covers a wide range of issues, we acknowledge that our guidance on forbearance needs to be strengthened urgently, as many firms visited have not adhered to it. So we are therefore proposing to make a number of changes to the arrears rules in a Consultation Paper to be published in January 2010.

We will consult on converting the forbearance guidance in our Mortgage and Home Finance: Conduct of Business Sourcebook (MCOB)—13.3.4G—into binding rules (see Annex A). Instead of suggesting the range of tools that *could* be used to help borrowers in arrears, we will *prescribe* a non-exhaustive list of tools that firms *must* employ to help customers in arrears. We also plan to update the rule to promote the other options (such as the various government schemes) that lenders should be promoting to borrowers in arrears.

This change should help ensure that borrowers in financial difficulties are treated fairly and are offered a range of solutions to help them to manage their way out of arrears. It should also ensure that the pricing and terms of future securitisation contracts will have to factor in options such as switching to interest only or allowing the mortgage term to be extended.

## Sub-prime/Specialist lending risks

In the first phase of our thematic arrears work we recognised that practices in the sub-prime and specialist market were poor in comparison to the mainstream market and we referred one firm to enforcement. The second phase of our work focused on specialist lenders who were no longer lending and on third party administrators, where the majority of their business came from the specialist lending sector. We published the findings of our review in June 2009 and at that time announced that a further four firms had been referred to enforcement as a result of unfair treatment of borrowers in arrears. Since then further investigatory work has resulted in another firm being referred for similar failings and we expect at least one more firm to be referred from the phase two work.

We are continuing to focus on firms whose business models and arrears and repossession levels are likely to indicate a high risk of unfair treatment for customers and will take whatever steps are necessary to improve outcomes for these consumers.

Most sub-prime/specialist lenders (many of whom were non-deposit taking lenders) had business models that offered mortgage finance to consumers who would have struggled to access credit from mainstream lending institutions. Typically products were offered to existing homeowners who were already struggling to repay their debts and needed to remortgage their properties to release equity. Many could not prove their incomes and most opted for interest-only mortgages to reduce monthly costs. Between 30% and 60% of borrowers on the books of these lenders are now in arrears. Such high arrears rates are a strong indication of these firms lending to individuals who were predictably unable to repay—in some cases within the first few months of the loan completion.

In the *Mortgage Market Review* we raise this issue under the heading of ‘High risk lending’ and consider whether prudential reforms will reduce high risk lending in future or whether

























