

Financial Services Consumer
Panel response to:
HM Treasury consultation
Regulating Mortgages

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Summary

- I. This paper represents the Financial Services Consumer Panel's view on the Treasury consultation "regulating mortgages". The Panel is responding separately to closely related consultations by the Treasury (on financial promotions and the regulated activities order) and to the FSA's consultation paper 70, on the regulatory regime for mortgages.
- II. The Panel remains of the view that the Government has made a mistake in deciding not to regulate mortgage advice. Our research shows that there is significant scope for consumer detriment during the advice process. *We ask the Treasury to monitor the new regime for problems that arise due to unregulated advice.*
- III. A key issue raised in the consultation paper is the boundary between the mortgage regulation regime and the existing consumer credit legislation. It is clear from the consultation paper that there is the potential for consumers to be confused as to which regime applies to their loan, and the consequences for consumers of being under one regime or the other. As currently drafted there may be particular confusions for consumers with flexible mortgages. *We ask the Treasury to ensure that OFT and FSA co-operate with each other to ensure that appropriate information passes between them, and that consumers are made aware of the boundaries of each regime.*
- IV. The Panel has considered the proposed definition of a regulated mortgage. The Treasury appears to have decided to construct a definition that is easy to use and then try to fit consumers into that definition. The Panel's view is that it would be more satisfactory to decide on the type of consumers that ought to be covered by mortgage protection and then try to construct a workable definition. The potential for consumer detriment from mortgages is not trivial, and this must be born in mind when deciding on the balance between effective regulatory coverage and the practicalities of tests.

- V. The Panel has identified a number of specific problems with the definition as proposed, where it thinks that the definition would exclude consumers that ought to be protected. The Panel has also identified some areas where in practice the tests proposed would not be entirely straightforward to conduct, and may lead to an overly intrusive regulatory regime.
- VI. *The Panel asks the Treasury to reflect on the issues it has raised with respect to the definition of a regulated mortgage, and consider whether there should be additional or different tests that would provide a better regulatory regime.* In particular the Panel asks that the Treasury considers reinforcing the definition of a regulated mortgage by including the location of the borrower as well as the property. The Panel also asks the Treasury to consider including unsecured loans linked to a flexible mortgage within the FSA mortgage regulation regime.
- VII. Whatever the Treasury's decisions in respect of the new regulatory regime, we would expect to see them supported by a better discussion of the issues than was contained in the consultation paper.

Panel response to HMT consultation paper: Regulating Mortgages

Introduction

1. This paper is the response of the Financial Services Consumer Panel ('the Panel') to the HM Treasury consultation paper "Regulating Mortgages". The Financial Services Authority (FSA) established the Panel to advise the FSA Board on the interests and concerns of consumers and to report on the FSA's effectiveness in meeting its consumer protection and public awareness statutory objectives.
2. The FSA is conducting a separate consultation on "Mortgage Regulation: The FSA's high level approach" (CP70). The FSA's proposals are strongly interrelated with the proposals put forward by HM Treasury. The Panel will respond separately to the FSA, but will send copies of both responses to both the FSA and to HMT.
3. HMT has published two separate consultation papers at the same time as its consultation on mortgage regulation, which deal with some related issues. The Panel is responding separately to HMT in respect of their third consultation on financial promotions, and in respect of their second consultation on regulated activities (the draft regulated activities order). Further information about the Panel is available on page 16.

General comments

4. The Panel considers that the Government has made an error of judgement by choosing not to regulate mortgage advice. The Panel's view is that the advice process is the source of many problems, particularly where complex products are involved. Our research shows that however good the written information provided, verbal information has a disproportionate influence on consumers' behaviour, and we note that there will be no requirement for consumers to be given the best, or even suitable, advice.

There is therefore considerable scope for consumer detriment under the proposed regime. The Panel requests that the Treasury monitors the new regime to identify where problems occur due to unregulated advice, or require the FSA to carry out the monitoring.

5. The Panel recognises that considerable effort has been put into establishing the boundary between those mortgages and other loans that fall within the Consumer Credit Act and those which form part of the FSA's mortgage regulation regime. However there is a significant risk of confusion for consumers and a risk that the market will restructure to operate under the least onerous regime. We expect OFT and FSA to liaise closely over the boundary issues and draw up appropriate systems to ensure the relevant information is passed between them. HMT should ensure that OFT and FSA liaise to ensure that consumers are aware of which regime they are protected by, and the consequences of being in one regime or the other. (For example the protection for consumers with arrears will be different - courts can make a Time Order (under s129 and s136) for a loan regulated under the Consumer Credit Act, whereas mortgage arrears would have to use the findings in C&G versus Norgan.)
6. The remainder of this document sets out the Panel's comments on the definition of a regulated mortgage proposed in the consultation paper, in particular the impact on consumers of the proposed definition. The headings and order of comments are the same form and order as used in the consultation paper.

Which mortgages?

7. The Panel agrees that mortgage regulation should aim to protect ordinary people taking out retail mortgages, and agrees that the definition of a regulated mortgage should be subject to careful scrutiny and testing to ensure that regulation will deliver this aim. But this does beg the question as to the meaning of "ordinary person", particularly as consumers do not form a homogenous group. The Panel highlights below a number of points

where the proposed definition would not in its view protect people who should be protected.

8. The Panel agrees that there would be problems in policing a purpose-based test for a mortgage, and there would be a risk that unscrupulous lenders could deny some customers the protections of mortgage regulation through artificial constructions if a purpose-based test alone was used. But this risk also applies to the objective definition proposed in the consultation document. The Panel's view is that the primary aim of the definition should be to give protection to those who should receive it and then to make that definition as workable as possible - not the other way around. Our comments on elements of the proposed definition are set out below.

First legal charge

9. The Panel's view is that for many consumers there will be no difference in the potential for detriment (through mis-buying or mis-selling) between a first charge mortgage and a second (or further) charge mortgage or loan. The Panel sees no reason why consumers' need for "*good quality, clear and comparable information about the mortgages on offer in the market*"¹ is any less for second charges or higher.
10. The Panel notes that under the proposed definition there would be no change to the protection for consumers with mortgages less than £25,000 secured by a second charge as they will continue to be covered by the Consumer Credit Act. The Panel is concerned that the system of dual regulation for certain types of mortgage product may be confusing for consumers and may make it more difficult for consumers to be aware of and exercise their rights under the regulations. It may be necessary for disclosure requirements under the Consumer Credit Act to be strengthened such that consumers are made aware that those loans are

¹ HMT consultation paper, paragraph 4

not covered by FSA mortgage regulation, and the consequences of the different regulatory regimes.

11. Where a consumer's second mortgage is above £25,000 there is no substantial regulatory protection other than, for example, the Unfair Terms in Consumer Contracts Regulations 1999, which regulates terms and conditions. The Panel's view is that there are likely to be some consumers with secured loans falling into this category who would benefit from the protection of a regulatory regime, for example consumers undertaking renovations or extensions to their property in order to accommodate changes in family size or structure. The introduction of mortgage regulation provides an ideal opportunity to extend the benefits of regulation to that type of consumer. The Panel notes that extending the definition of a regulated mortgage may bring in some loans that are not "ordinary people with retail mortgages", however it is not clear that there is always a direct link between the amount borrowed and the mortgage expertise of the borrower".

12. The Panel has also identified some potential artificial arrangements that unscrupulous lenders may adopt to 'get around' this part of the definition. Some lenders may be unwilling to grant second mortgages below £25,000 (or will show a preference for granting amounts of £25,001 or more). It may also be possible for some lenders to apply a nominal first charge to a property, whilst securing the bulk of the money outstanding against a second charge, thus bringing it outside the regulatory regime.

Loans secured on properties in the UK

13. The consultation document proposes that a regulated mortgage should apply only to loans secured on a property in the UK. The Panel accepts that this is an appropriate minimum level of protection. The Panel is concerned, however, that there may be some consumers who would be excluded from regulatory protection by this definition - in particular consumers who have an income in £ sterling and therefore wish to take

out a mortgage in £ sterling from a UK lender on a property located outside the UK (for example, in the Republic of Ireland). The Panel suggest that HMT consider whether to supplement this test by including mortgages on non-UK properties where the mortgage is capable of being enforced in UK courts by the lender. The Panel agrees that timeshare properties should be excluded from mortgage regulation.

14. The Panel notes that a complete definition of a mortgage would also include a statement on the location of the borrower and lender. Whilst this may be a superfluous requirement for the majority of mortgages secured on properties in the UK, it may become more important to provide consumers with the reassurance of protection when business is carried out over the internet or other e-commerce channels. The Panel suggests that the definition of a regulated mortgage be amended to state that borrowers in the UK will be covered by FSA regulation.

Loans ... at least 40% residential ... occupied by the borrower or their immediate family

15. The Panel's understanding is that the concept of a 40% threshold for classifying a property as 'residential' already exists under present building society legislation. The consultation document did not provide any evidence on the success of this threshold in practice, or any indication of the number of properties that may be affected. If the threshold has worked well in practice, the Panel sees no strong reason to change to a new industry standard. However, this is an ideal opportunity to address any known problems associated with this standard.

16. The definition of 'immediate family' both in the consultation document and in the consultation on the RAO is narrow and does not reflect the actual pattern of family life in the UK today. An improvement may be to use the "close relatives" definition in the RAO, although this would exclude unmarried partners and ex-spouses, which we consider to be unacceptable and unjustified. If the motivation for the narrow definition

was a fear of bringing buy-to-let transactions into regulation then that should be dealt with directly in the definition, and not through the definition of immediate family.

Loans granted for ... at least five years

17. The Panel's understanding is that the five year minimum is intended to draw a distinction between mortgages and other consumer credit, which will remain regulated by consumer credit legislation. The Panel is concerned that the five-year limit may not accurately reflect this distinction in some cases and may have a detrimental impact on some customers. In particular it would discourage consumers with less than five years remaining on their mortgage from re-mortgaging. There may also be some consumers who wish to take out a mortgage for less than five years (for example consumers close to their planned retirement date) or consumers who wish to extend their mortgage beyond its original term who would be excluded from mortgage regulation under this proposal.

18. It may be possible to mitigate these problems through a revision to the legal drafting - although this may only serve to make unscrupulous lenders concoct more ingenious methods to circumvent the legislation. In any case we are not convinced that any length of time is an appropriate or sufficient test of what constitutes a regulated mortgage.

19. The discussions of the proposed definition above suggest that there will always be problems in relying solely on an objective based tests to define a regulated mortgage as these may exclude consumers who we think should be given the protections and benefits of mortgage regulation. We think that consumers will not accept that they should not benefit from mortgage regulation simply because they do not fit into a neat and tidy and arbitrary category.

20. Annex A of the consultation document outlines types of mortgages and secured loans that will and will not be regulated. The Panel considers that this list suggests some practical difficulties with the proposed definition.

For example how is a lender to determine whether the student child of a borrower is to use more or less than 40% of a property? How should a lender treat a borrower who has not used their holiday home in the past year (indeed how is a lender expected to know)? How should a lender classify, for example, a clergyman or diplomat who has taken out a mortgage on a property with a view to renting it out to third parties in the short term but occupying it themselves at some stage in the future? These issues suggest that the regulatory regime may in practice become more intrusive than lenders (perhaps) and consumers would wish.

21. It is clear that the proposed definition of a regulated mortgage would exclude some people who would benefit from regulation. The Panel asks the Treasury to reflect on the issues and problems we have raised and consider whether some additional tests on a different basis would prove more acceptable and equally workable, for example the inclusion of a "by way of business" test. Whatever the Treasury's decision, we would expect to see it supported by a better discussion of the issues than was contained in this paper.

Which processes?

22. The Panel notes the Treasury's policy decision to regulate mortgage lenders only and not to regulate advice. We have commented on the need to regulate advice in detail in our response to the Treasury consultation on mortgages in 1999². We believe the Government decision on this point to be flawed.

23. The Panel believes that if regulation was extended to advice this would benefit consumers by having a more understandable regulatory regime, and our research has found considerable problems with advice. The current proposals that require unregulated brokers to have certain promotions approved by an authorised person who does not work for that

² Financial Services Consumer Panel response to HM Treasury discussion paper on mortgage regulation, October 1999

firm is a solution that blurs the boundaries of responsibility and may confuse consumers.

Which firms?

24. The Panel notes that the proposal in paragraph 28 of the consultation paper is to apply a "by way of business" test to determine whether a mortgage lender will require authorisation. We draw your attention to our comments in our paragraph 21 on the definition of a regulated mortgage.

25. The Panel is concerned that paragraph 30 (of the consultation paper) suggests that local authorities may not be exempt from regulation, but the decision will rest with the courts. Whilst the Panel does not think that local authorities should be exempt, it is concerned that in the absence of clearer guidance, this uncertainty may damp down the emerging equity release market for long term local authority loans for long term care and house repairs.

26. The Panel has considered the comments in paragraphs 32 to 35 relating to foreign lenders and passported firms. The Panel accepts that foreign firms operating in the UK should be subject to the same regulation as domestic firms, and that the protection given to consumers by mortgage regulation should not depend on the domicile of the firm. The panel is, however, concerned that consumers may inadvertently stray beyond the boundary of regulated firms or products, which may be a particular problem for internet business. The Panel asks that the definition of a regulated mortgage be reinforced by adding a requirement that the borrower be in the UK, thus there would be no doubt as to whether the regulatory regime applied.

Related consumer lending

27. The Panel has noted the Treasury's proposals for fitting flexible mortgages into the new regime. Clearly, where one part of the flexible mortgage consists of an unsecured loan consumers are protected from detriment of

that part of the flexible mortgage by the Consumer Credit Act, and it does not appear to fit the general description of "retail mortgages for ordinary people". Nonetheless there is a great deal of scope for consumers to be confused as to whether, how and which parts of their flexible mortgages might be regulated. The Panel's view is that the regime applied to flexible mortgages should be made clearer and simpler.

28. The Panel suggests that that unsecured loans linked to a flexible mortgage ought to be included in the FSA mortgage regulatory regime so as to minimise confusion for customers. To a consumer, a flexible mortgage is one product and should have one regulatory regime. We see no simple alternative. In general, the Panel's view is that the Treasury should be trying to design a regime that fits flexible mortgages rather than trying to fit flexible mortgages into a regime.

29. There is a more general issue of how consumers are to be informed of the boundaries between regulated mortgage lending, other regulated consumer credit, and unregulated lending. The Panel considers that there is potential for consumer detriment if consumers are unaware of (and unable to exercise) their rights. This may in particular be the case when a loan moves from one set of regulations to another or none at all. Different complaints and compensation arrangements will also apply depending on the nature of the product. The Panel suggests that Treasury requires the FSA and OFT to inform the public of the boundaries between the various products, and the impact and protections of each regulatory regime. There should be a mechanism for informing borrowers if they are about to leave or change regulatory regimes.

Loans sold or transferred to other lenders

30. The consumer panel agrees that outright sales or securitisations of mortgage portfolios are beneficial for consumers as they provide a way for lenders to spread risks and reduce the costs of funding, which will ultimately benefit the consumer. Mortgage regulation should therefore be

constructed not to interfere with the sale or securitisation market. However, from the perspective of consumers, what is important is the protection from abuse that the FSA will provide - and that should not depend on whether the original lender has or has not sold or securitised his portfolio. The Panel is concerned that the relevant legal drafting in the RAO may not provide adequate protection against lenders who wish to remove their mortgage portfolio from regulation.

31. The panel is concerned that the definition of "the rights holder" in the current draft of the RAO may be open to abuse by unscrupulous lenders. Under Article 57, where the original lender remains in place, the exercise of any right by him under the contract is a regulated activity. However, where the rights holder is someone else, the scope of the regulated activity can be significantly narrower. This is because of the definition of the rights holder, which may allow the new person to limit his functions to "most key decisions". Someone else outside the regulatory net could then take the rest of the key decisions and all other decisions. It is possible that this could include decisions on repossession, which would not be acceptable.
32. The Panel believes that such differences in the scope of regulated activities cannot be justified and that Treasury should consider the drafting of the RAO in the light of these comments.

Conclusions

33. The Panel has carefully reconsidered the proposals made by the Treasury. Our over-riding concern is that mortgage advice is not subject to regulation, and we believe this will lead to consumer detriment. Our explicit requests to Treasury are summarised below:
- HMT should monitor the new regime (or require the FSA to monitor) to identify where problems occur due to unregulated advice. (Para 4)

- HMT should reflect on comments made by the Panel (in paragraphs 7 to 20) in respect of the proposed definition of a regulated mortgage and consider if modified or additional tests would be more appropriate. (Para 21)
- HMT should consider reinforcing the definition of a regulated mortgage by including the location of the borrower (as well as the property) in the definition of a regulated mortgage. (Para 26)
- HMT should include unsecured loans linked to a flexible mortgage within the FSA mortgage regulation regime. (Para 28)
- HMT should require FSA and the OFT to liaise closely with each other and provide borrowers with information on the regulatory protections under each regulatory regime. (Para 29)
- HMT should consider the drafting of the RAO in respect of the definition of a "rights holder". (Para 32)

Who is on the Panel?

Barbara Saunders (Chairman)

Barbara is a public interest member of the PIA Board. She is an independent consumer consultant and past Chairman of the Council of the Insurance Ombudsman Bureau. Among other public and professional appointments she is a Non-Executive Director of the West Hertfordshire Hospitals NHS Trust and a member of the Architects Registration Board.

Colin Brown (Vice Chairman)

Colin is an independent consultant specialising in consumer affairs. Previously Deputy Director of Research at Consumers' Association and Senior Fellow at the Policy Studies Institute, he has over 20 years' experience of social and consumer research.

Jean Gaffin

Jean was for 7 years until December 1999 Chairman of the Advisory Committee on Telecommunications for Disabled and Elderly People that provides advice to the telecommunications regulator, OFTEL, and is a Non-Executive Director of Harrow & Hillingdon Healthcare NHS Trust. She has extensive experience of working on behalf of vulnerable consumers. Previous positions include: the Executive Director of the National Council for Hospice and Palliative Care Services and Chief Executive of Arthritis Care.

Yvonne Gallacher

Yvonne is Chief Executive of Money Advice Scotland, which was set up by the Scottish Consumer Council. She has over 10 years experience of consumer credit/money advice issues and of working with vulnerable consumers in a variety of roles, including debt counsellor, trainer and manager. She is Co-Director and Secretary of the Government funded Lead Body for Advice, Guidance, Counselling & Psychotherapy (CAMPAG). Yvonne is a member of the Scottish Consumer Council.

Joan Harbison

Joan is Chief Commissioner of the Equality Commission for Northern Ireland. She has been Chair of the Commission for Racial Equality for Northern Ireland since its inception in 1997 and is a former Chairman and member of the Executive Committee of the Northern Ireland Association of Citizens' Advice Bureaux. She has held a number of public appointments including being Vice Chairman of the Eastern Health and Social Services Board and the Northern Ireland Standing Advisory Commission on Human Rights and former member of the Human Fertilisation and Embryology Authority.

John Howard

John is a solicitor with extensive experience as a former presenter/editor of the daily consumer programme on Radio 4 'You and Yours'. John is currently a freelance broadcaster and his work includes presenting personal finance TV programmes. He is a member of the Mortgage Code Compliance Board.

Vinod Kumar

Social scientist with market research skills and extensive voluntary and public sector experience of policy analysis and research. Now retired, Vinod has previously worked for the Commission for Racial Equality and was Head of Policy and Research at the Royal National Institute for Deaf People. He is currently Non-Executive Director of Barnet Health Authority, Board member of the South Barnet Primary Care Group and member of the Consumer Liaison Group of the Medical Research Council.

Gerald Lanchin

Gerry is a Vice President of the National Federation of Consumer Groups. He is a former Under Secretary of the Consumer Affairs Division of the Department of Trade and Industry and author of "Government and the Consumer". His involvement in consumer protection includes being a former Council Member of Consumers' Association and of Consumer Congress Committee. He was the first chairman of the Direct Mail Services Standards Board and a member of the Data Protection Tribunal for 10 years.

Nick Pearson

Nick is the National Money Advice Co-ordinator for the Federation of Information and Advice Centres. A career spent in advice organisations including the National Association of Citizens' Advice Bureaux where he was manager of the Money Advice Support Unit, he has particular experience of credit, debt and personal finance issues and of working with vulnerable consumers.

Paul Salvidge

Paul is a former Senior Civil Servant with extensive experience of regulatory work, employment law, competition, consumer protection, telecommunications, financial services and company law. He was previously Competition Policy and Consumer Affairs Director at the Department of Trade and Industry.

Richard Smethurst

Richard is Provost of Worcester College, Oxford University; he chairs the Training Standards Panel of IMRO, of which he is a non-executive Director. He has served as an economic adviser in Whitehall, and the Monopolies and Mergers Commission, where he was Deputy Chairman. Richard lectures widely on financial and economic topics to businessmen and adult education groups. He is President of the National Institute of Adult Continuing Education.

Jane Vass

Jane is an independent consumer researcher specialising in financial services. She was previously Head of the Financial and Economic Research Group at Consumers' Association and is still author and editor of a number of Consumers' Association publications in addition to other research, including work for the National Consumer Council. Her current committee memberships include: Council of the Ombudsman for Estate Agents, the Inland Revenue Tax Law Rewrite Project Consultative Committee, the PIA Training Advisory Group and the FSA Training Advisory Panel.

Dave Watts

Dave is a partner in a media business which is involved in publishing, editing and journalism - personal finance plays a large part in this. He is a former editor of "Which?" and "Money Which?" and former Assistant Director of Consumers' Association. He was also a policyholder representative on the Insurance Brokers Registration Council for nine years.

How to contact the Panel

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