Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Financial Services Consumer Panel response to: HM Treasury's consultation on CAT standards for mortgages

17 November 1999

Mortgage CAT Standards

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Introduction

1. This is the response of the Financial Services Consumer Panel to the Treasury's consultation on CAT standards for mortgages. The Financial Services Consumer Panel (the Panel) was established by the Financial Services Authority (FSA) 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. Further information about the Panel can be found at the end of this response.

General comments

2. Mortgage CAT standards are not a substitute for the statutory regulation of mortgages. Whilst CAT standards will address many of the product-related problems that the Panel identified in its response to the Treasury's consultation on mortgage regulation, they will not tackle all areas of potential consumer detriment such as problems with advice and unclear information. At Annex A we assess the extent to which the proposed CAT standards will address the problems we have identified. As Annex A shows only 4 out of the 15 problems we identified will be addressed by mortgage CAT standards. CAT standards will not address problems such as:

   - the difficulty of comparing the cost of different mortgages;
   - problems with the quality of advice;
   - biased advice resulting in unsuitable sales of endowment, pension and non-status mortgages;
   - lack of clear mortgage documentation.

   Furthermore as the proposed CAT standards are voluntary they will only deal with the product related problems for <u>some</u> mortgages.

3. Despite these limitations, we welcome the proposed CAT standards for mortgages which should provide simpler and safer mortgages for consumers, particularly if coupled with statutory regulation. We have recommended 12 changes to the Government's proposed CAT standards (see paragraph 11 of this response) so that they better address potential consumer detriment.

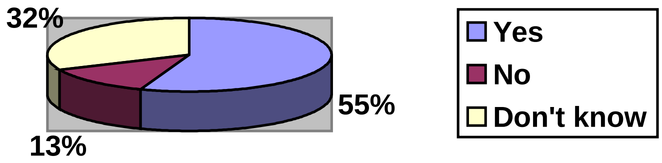
4. We remain concerned that about the possible 'halo' effect, with CAT standard mortgages being perceived as a Government guarantee. The Government should ensure that resources are made available to educate consumers about CAT standards to make clear that they do not guarantee either affordability or suitability of the mortgage. It will also need to be

made clear to consumers taking out interest-only mortgages that the CAT standard only applies to the mortgage loan and not to any investment to pay off the mortgage.

How can the impact of CAT standards be maximised?

5. Experience of voluntary CAT standards in the ISA market shows that their potential effect on the market has not been maximised because of low consumer awareness. For example, as Figure 1 shows a third of consumers who had purchased an ISA did not know whether it met the CAT standard or not.

Figure 1: Awareness of whether ISA meets CAT standards (August 1999)



Source: NOP Financial Research Survey (1999)

Base: all with an ISA (927 respondents)

6. We think it is essential that advisers are required to disclose whether or not the mortgage they are selling meets the CAT standards. It is greatly to be regretted that the CML has rejected disclosure if a mortgage does not meet the CAT standard as part of the key features document that it has issued for consultation. Mandatory disclosure of whether or not mortgages meet the CAT standards is essential for all mortgages and should be included in the CML's key features document.

7. But experience with ISAs also suggests that it is insufficient for CAT standard disclosure to only feature in written 'key features' documents. Our research[1] shows that many consumers are overwhelmed by the documentation they receive with their mortgage and do not read it in detail. We recommend that:

[1] For further details see our response to the Treasury's consultation on mortgage regulation (October 1999)

- mortgage advisers must be required to state orally whether or not the mortgage they are recommending meets the CAT standards;

- 'reason why' letters that are issued under the Mortgage Code to customers who have received advice and a recommendation about which mortgage to take out should state whether or not the recommended mortgage meets CAT standards and if appropriate explain why a non-CAT standard mortgage is being recommended; and

- the standardised key features documents that the CML is planning to introduce should contain an explanation of CAT standards (regardless of whether the mortgage in question meets those standards) and should clearly disclose whether or not the mortgage meets CAT standards and set out in what way it fails to meet the standards.

These requirements would best be enforced by statutory regulation or in an interim period before statutory regulation by changes to the Mortgage Code.

8. We think there will be real problems of firms 'working around' the CAT standards and adding to consumer confusion. Lenders who do not wish to meet the CAT standard might, for example, offer loans which track the London Inter-Bank Offered Rate (LIBOR), rather than the base rate, so that they are not easily comparable with CAT standards mortgages. For this reason, we suggest that if the effectiveness of CAT standards is to be maximised there needs to be an enforcing body ruling on whether mortgage promotions are keeping within the spirit of the standards. This role should be performed by the FSA. The FSA should also have powers to oversee and enforce the standards and to conduct research on the impact of standards on the market and consumers.

9. There might also be problems in introducing CAT standards into an existing market which is highly competitive (in some senses) and innovative; problems that did not exist in the ISA market where the product was new. At a very basic level, for example, smaller mortgage lenders might not be prepared to spend time and money changing their existing mortgage range in order to meet a CAT standard. We therefore think it is important that the standards should be capable of being changed quickly if necessary and adapted in light of innovation.

Proposed standards themselves

10. We support many of the features of the proposed CAT standards, in particular the requirements for the interest rate for variable loans to be reduced in line with reductions in the base rate and for redemption penalties for fixed and capped rate mortgages to be made clear.

11. We recommend 12 changes to the proposed CAT standards as follows:

__Charges__

- allowing four weeks for the interest rate for variable mortgages to decrease following a reduction in the base rate is over-generous to lenders and should be reduced to two weeks. A parallel requirement should be introduced that interest rates can only increase two weeks after an increase in the base rate;

- low minimum limit on capital repayments, of say £50-£100. This would deal with the problems of high limits that are set by lenders;

- a requirement for the interest rate to track the base rate for the fixed/capped rate mortgage CAT standard at the end of any special deal. The problem with many existing capped/fixed rates is that borrowers have to pay an unknown standard variable rate at the end of the fixed/capped rate period making it difficult to judge whether the fixed/capped rate is a good deal;

- removing the provision allowing booking or arrangement fees to be charged. We can see no justification for lenders charging £200 for doing nothing;

__Access__

- CAT mortgages should be available for any length of term, not just 25 years. In a low-inflation economy, it is in borrowers' interests to reduce their debt as quickly as possible;

- the provision requiring CAT mortgages to be available on the lender's "normal" terms needs to be made more specific. As drafted "normal" is extremely ambiguous leaving lenders with a huge loophole to define "normal" very tightly;

- the provision of "no restriction to existing customers" is also vague. We think it should be made clearer that a lender's existing customers can transfer to any better value CAT standard mortgage their lender is offering. It is important that existing customers are made aware of new CAT standard mortgages so that they have the option of re-mortgaging if they wish;

- CAT standard mortgages should be available regardless of what proportion of the property value the mortgage covers otherwise lenders could refuse to offer CAT standards to those with high loan to value mortgages and the MIG provision in the CAT standards would not bite;

__Terms__

- mortgage documents should disclose on a customer-specific basis any redemption penalties for fixed and capped rate mortgages throughout the fixed/capped rate period in monetary amounts;

- the arrears provision should be strengthened by the following requirement:
  "In the event of a borrower falling into arrears, the lender will negotiate mutually acceptable repayments on the basis that the borrower has the remainder of the term to clear any arrears accrued".
  This provision would incorporate 1995 Court of Appeal judgement in the case of Cheltenham and Gloucester v Norgan[2] into the CAT standards. Research by the National Association of Citizens Advice Bureaux [3] shows that the Norgan judgement has had no impact on the offers lenders were prepared to accept for repayment of arrears. The CAT standards should apply regardless of arrears;

- the CAT standard should apply for the whole of the mortgage term. We note that the Treasury's consultation states that: *"lenders must be committed to continuing to offer CAT standard terms to their borrowers once a mortgage loan has been made"*, but there are no details in the consultation as to how this will be enforced. It does not seem reasonable to vary a contract with 6 months notice as proposed. However, if provision to vary a contract is permitted then as well as adequate notice, borrowers must also have a right to a penalty-free redemption even if it occurs when the interest rate is fixed or capped;

- lenders should not deem shortfalls incurred as a result of the Benefits Agency four week benefit cycle compared with lenders' monthly cycle as arrears. The Banking and Building Societies Ombudsman noted that this was still a problem in their response to the Treasury's consultation on mortgage regulation.

12. The Treasury should conduct research to establish a reasonable charge for the cost of capital to inform its decision on how many points above the base rate the interest rate should be set given the huge impact this will have on the market.

[2] The court held that a starting point for determining a reasonable period for payment of arrears was the remaining terms of the mortgage ([1996] All ER 449).
[3] Quoted in National Association of Citizen Advice Bureaux - Response to H M Treasury consultation on the regulation of mortgages (October 1999)

Appendix A: Consumer problems and potential consumer detriment

Problem/potential detriment	Do the CAT standards address this?
ADVICE PROBLEMS	
Confusion about the status of mortgage advisers (tied or independent)	NO
Poor quality advice: failure to assess consumers' needs and unsuitable sales	NO
Biased advice leading to unsuitable sales of endowment mortgages	NO
Biased advice leading to unsuitable sales of pension mortgages	NO
Unsuitable sales of non-status loans	NO
INFORMATION PROBLEMS	
Clarity of information	Only partly – no disclosure requirements
PRICE PROBLEMS	
Difficulty of comparing prices	NO
Annual interest rate calculations	YES
Failure to pass on base rate decreases within a reasonable time -Variable rate	YES
Failure to pass on base rate decreases within a reasonable time - Capped/fixed rate	NO
High minimum limits for lump sum repayments	NO
Penal arrears charges	Only partly – arrears up to 3 months
PRODUCT RELATED PROBLEMS	
Tied insurance	YES
Redemption penalties	YES
Mortgage indemnity guarantees (MIGs)	Only partly – potential loophole for high loan to value ratios

About the Financial Services Consumer Panel

The Financial Services Consumer Panel was established by the Financial Services Authority (FSA) 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. There are eleven members of the Panel representing a broad range of consumer interests. The Panel is independent of the FSA – it can raise its own concerns, initiate its own research and publish its own reports.

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 St Albans and Hemel Hempstead 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 is Chairman of the Advisory Committee on Telecommunications for Disabled and Elderly People that provides advice to the telecommunications regulator, OFTEL, and 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.

Noel Hunter

Noel is County Trading Standards Officer for Warwickshire. A National Council member of the National Consumer Council, he also chairs the Management Board of the Institute of Trading Standards Administration and is an adviser to the Local Government Association.

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 Independent 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.

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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