Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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By email: FPCMortgageMarketConsultation@bankofengland.co.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to the Bank of England Financial Policy Committee consultation on withdrawing the mortgage affordability test Recommendation

The Financial Services Consumer Panel is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK. The emphasis of our work is on activities that are regulated by the FCA, however we also look at the impact on consumers of activities that are not directly within but are still relevant to the FCA's remit. We are responding to this consultation on the basis that its proposals are relevant to the operation of the FCA's MCOB rules and its monitoring activities in the consumer debt sector, particularly in the context of the cost-of-living crisis.

The effect of withdrawing the mortgage affordability test Recommendation is unclear at this point, given that the Financial Policy Committee's (FPC) proposals come at a time of significant economic uncertainty at both a domestic and global level. The Panel is extremely concerned about how this policy change will affect consumers in the context of the deepening cost-of-living crisis and we recommend that the Bank of England (Bank) take the following contextual factors into account before taking steps to withdraw the Recommendation.

Timing of the withdrawal of the Recommendation

In support of withdrawing the affordability test, the Bank's Financial Stability report[1] (December 2021) asserts '*there has been little evidence of a deterioration in lending standards, a material increase in aggregate household debt or the number of highly indebted households*'.

While this statement might have been accurate at the time of writing, circumstances have since changed quite dramatically. There is, for instance, clear evidence that the situation has deteriorated significantly in the last six months, with a rapidly increasing number of consumers struggling financially due to the long-term impacts of the COVID pandemic (including changes to income), the cost-of-living crisis (including soaring energy bills and increased food prices exacerbated by the war in Ukraine) as well as rising interest rates. There is little promise that any of these changes will be short-lived.

These circumstances are placing mounting pressure on household finances and increasing the number of consumers in vulnerable situations – a number which, according to the FCA's latest Financial Lives Survey, had already risen in 2020 with the onset of the

[1] See https://www.bankofengland.co.uk/financial-stability-report/2021/december-2021

pandemic[2]. According to Citizens Advice, one in ten families (equivalent to 3.2 million households) faced financial crises this past winter[3]. The Joseph Rowntree Foundation found that low-income households will be spending on average 18% of their income after housing costs on energy bills after the energy price cap increase in April. For single adult households on low incomes this rises to 54%, an increase of 21% since 2019/20[4]. Beyond energy bills, there is evidence that the number of people who cannot meet their general living costs (a negative budget) has been increasing over time. To illustrate, the proportion of people that Citizens Advice helps with debt who have negative budgets has grown since 2016 from 32% to 38%[5].

The Panel is very concerned that the factors mentioned above are exacerbating the risks of household over-indebtedness, leading to a 'gathering storm' of debt. Highly indebted households are more likely to face difficulties making repayments on their mortgage and other consumer debt. We therefore urge the Bank to reconsider whether it might not be more appropriate to recalibrate and improve the affordability Recommendation than to remove it.

Quantifying the risk of consumer harm if the Recommendation is withdrawn

There is uncertainty around the number of borrowers currently affected by the mortgage affordability test and a lack of clear evidence or risk analysis to support the assumption that the FCA's MCOB rules, together with the Bank's loan-to-income (LTI) rule, will be sufficient to protect consumers. Crucially, the FPC's consultation does not recognise the current cost-of-living crisis and rapidly increasing levels of household debt we have highlighted in the section above. We therefore urge the Bank to undertake further risk analysis to assess whether this assumption still holds in the context of the deteriorating financial position of many UK households as well as the potentially stretched assumptions that house buyers may be making. Younger house buyers, who will not have experienced periods of rising interest rates, high inflation or falling house prices, could be particularly vulnerable to optimistic assumptions and yet could also potentially be faced with the spectre of all three – falling into negative equity at the same time as they face higher mortgage costs and lower real incomes.

The Panel is also concerned that, in practice, the approach to affordability testing in the absence of the FPC's Recommendation may vary across lenders, which could lead to greater harm and variable outcomes for consumers.

If the affordability test is withdrawn, the Bank would need to keep this decision under continual review and monitor consumer impacts and risks, and particular emphasis should be put on monitoring lenders' compliance with the FCA's MCOB rules. The Panel fully supports the FPC's commitment to recalibrate existing measures or introduce new measures if there is evidence of consumer harm as a result.

Our responses to the specific questions are included in Annex A below.

Yours sincerely,

Wanda Goldwag
Chair, Financial Services Consumer Panel

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[2] See https://www.fca.org.uk/publications/research/financial-lives-2020-survey-impact-coronavirus
[3] See https://www.citizensadvice.org.uk/about-us/about-us1/media/press-releases/three-million-families-facing-crisis-as-cost-of-living-crunch-bites/
[4] See https://www.jrf.org.uk/press/rising-energy-bills-devastate-poorest-families
[5] See https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Negative%20budgets%20report%20-%20phase%201%20(1).pdf

ANNEX A – Responses to questions

Question 1: What impact do you think the affordability test Recommendation is currently having on the mortgage market?

No comment.

Question 2: How do you think lenders and the mortgage market would respond if the Recommendation were withdrawn? If applicable, please also comment on how you or your institution would respond.

No comment.

Question 3: What effect do you think withdrawing the Recommendation may have on the housing market as a whole and on particular segments of the market?

The effect of withdrawing the Recommendation is highly uncertain and we have outlined our main concerns about this proposal in the cover note above.

The Recommendation was originally introduced to reduce the risk of homeowners accidentally taking on debt that could leave them vulnerable and was intended to protect homeowners from any volatility that could come from interest rate rises. Withdrawing the Recommendation could enable buyers to take out mortgages with greater ease than was possible prior to the rule change. However, the Panel is concerned that, in the current economic climate, the potential risks could outweigh the benefits. The scale and nature of harm experienced could be even greater for consumers in vulnerable situations.

Firstly, the proposed changes could enable consumers to take on significant mortgage payments that are not sustainable in the long term, particularly if there is a negative change in the borrower's personal circumstances, or further decline in the UK economy, which is not unlikely given the volatility of the current situation. The recent boom in house prices may have led to consumers taking on more debt than they can afford and – should there be an economic downturn later this year – there is a risk that some homeowners could be left in negative equity.

Secondly, the Panel is concerned that, in the absence of the Recommendation, lenders may adopt inconsistent approaches to affordability testing, though it is unclear if lenders would relax their requirements given the uncertainty surrounding interest rates and the cost-of-living crisis. Nonetheless, inconsistency across lenders could lead to variable outcomes for consumers and exacerbate the risks of household over-indebtedness mentioned elsewhere in this response.

As highlighted in the cover note, we urge the Bank to undertake further risk analysis to understand the potential impacts of withdrawing the Recommendation in the current economic context, taking into account the more recent effects of inflation, interest rate increases and sharply rising energy costs, before proceeding with its proposals. Again, it might be more appropriate to recalibrate and improve the Recommendation than to remove it.