

**SOCIETY**

**matters**

No. 19 Spring 2011

**Mortgage Regulation**

Policy special

Featuring

Yorkshire Building Society

Ipswich Building Society

Financial Services Authority

Regulatory reform

**Five minutes with**  
**Jonathan Evans MP**  
All Party Group Joint Chair

 **Building Societies**  
Association

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JONATHAN EVANS, MP

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WE TAKE A LOOK AT WHERE WE ARE NOW WITH THE MMR AND WHAT IS ON THE HORIZON FROM BOTH THE UK REGULATOR AND EUROPE.

from both the UK regulator and Europe. It certainly puts into perspective how vast the proposals are.

Sheila Nicoll from the FSA assures us they are listening to our sector's concerns and that what the FSA does not want to see is a return to some of the poor lending practices of the past.

We get the views of two BSA members - Yorkshire and Ipswich building societies. Paul Winter from the Ipswich asks the question "will the MMR deliver for customers?" He points out that the current proposals come against the background of an economy just beginning to emerge from the worst post-war recession and a very fragile housing market. There is a danger, he says, of too restrictive rules that could create further disruption to the housing market which is vital to the growth of the economy as a whole.

Yorkshire's Lynne Foreman says the FSA must remember the need for proportionality within the work it undertakes, particularly the MMR. There is not a 'one-size-fits-all' solution.

Away from the policy special we spend five minutes with Conservative MP Jonathan Evans, Joint Chair of the All Party Group for Building Societies and Financial Mutuals. He tells us that whilst mutuals are good at putting the customer at the heart of their business, improvements could be made on corporate governance. He also urges the Coalition Government to appoint a Minister for Mutuals.

Enjoy the Spring edition.

**Rachel Wylie (née Le Brocq)**  
*Society Matters* Editor

The Mortgage Market Review could have a profound affect on the UK's mortgage and housing markets and ultimately the wider economy. On top of the FSA's wide-ranging proposals, we also have looming the European Commission's Directive on Responsible Lending and Borrowing. It seems only fitting, therefore, that this edition's policy special looks at mortgage regulation, in particular the MMR.

Paul Broadhead, the BSA's Head of Mortgage Policy, looks at where we are now with the MMR and what is on the horizon

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## FIVE MINUTES WITH... JONATHAN EVANS

CONSERVATIVE MP FOR CARDIFF NORTH AND JOINT CHAIR OF THE ALL PARTY PARLIAMENTARY GROUP (APPG) FOR BUILDING SOCIETIES AND FINANCIAL MUTUALS.

JONATHAN IS JOINT CHAIR OF THE APPG FOR BUILDING SOCIETIES AND FINANCIAL MUTUALS. HE HAS EXTENSIVE BOARD EXPERIENCE IN THE INSURANCE SECTOR AND HAS CHAIRED ONE OF THE UK'S MAJOR INSURANCE GROUPS. HE ALSO SERVED FOR 10 YEARS ON THE BOARD OF NFU MUTUAL.

He is a solicitor and former Director of Insurance Law with Eversheds in the City. He served a decade in the European Parliament, leading the Conservative Group, and later as President of the Committee for relations with the US Congress. He served for two years on the Bush/Merkel Transatlantic Economic Council. He is a former Corporate Affairs Minister at the Department of Trade and Industry.

**The best way the Coalition Government could demonstrate its pledge to foster diversity and promote mutuals is** to speedily appoint a Minister for Mutuality, based in the Treasury or BIS, with specific responsibility for taking forward the Coalition Government's commitment to promote mutuality, with a seat on every Ministerial Committee which has powers in this area.

**I think the mutual sector does well at** placing the customer at the heart of the business process. Having a customer who is also a stakeholder in the business should fundamentally change the mindset of management. Customers must be recognised as the shareholders of the business. As a result there ought to be little need for government regulators to require mutual businesses to be treating their customers fairly when

mutuals demonstrably recognise that the customer is such a stakeholder.

**But it could be better at** corporate governance. I would like all mutuals to fully review the means they employ for communicating with their customers and place a high value on customer engagement. Mutuals should make it easier for customers to participate in elections to their Boards. Whilst recognising that Boards may wish to make recommendations for Board appointment, more needs to be done to increase voting participation, and fuller communication on the policy and strategy of the business. There is clear evidence of a culture of complacency in some businesses - Equitable Life being a glaring example. Mutuals should be able to show that they are earning their mutuality by demonstrating better outcomes for customers.

**The most important financial lesson I have learnt is** the need for management to be regularly and unashamedly challenged on the strategy and performance of our mutual financial businesses. We certainly have some top class business leaders in the mutual sector, but recent events have shown that the financial services sector has been let down by having too many 'followers' rather than 'leaders.'

**I am proud to represent Cardiff North in Parliament because** I went to school in Cardiff and have lived and worked in the City for most of my life. My wife and I were married here and all three of our children were born in the constituency. There is a special feeling of personal satisfaction in having the honour of being elected to represent your neighbours in an area you know so well. It's also great to be the MP for many friends (and perhaps even one or two political opponents) I have known for very many years. I'm also a perennially optimistic Cardiff City fan!!

**My inspiration has been** serving for a decade on the Board of NFU Mutual, a mutual company founded by seven Midlands farmers which has risen to become one of the UK's leading financial services companies, and realising that my Boardroom contribution amounted to just 10% of its centenary of UK business life.

**Currently sitting in my in tray is** the draft agenda for the next sitting of the APPG's Inquiry into Government policy on promoting mutuality. We have

already heard some promising observations from Hector Sants of the FSA on the need for the regulatory mechanisms to include a clearer responsibility for mutuals. Now we need to get Coalition Government Ministers to build on their commitments.



Jonathan Evans

# REFORMING THE HOUSING MARKET TO SUPPORT THE ECONOMY

BY JOE THOMPSON, BSA BUSINESS ECONOMIST



IN A RECENT REPORT - *HOUSING AND THE ECONOMY: POLICIES FOR RENOVATION* - THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) CONCLUDES THAT BADLY DESIGNED HOUSING POLICIES IN VARIOUS OECD COUNTRIES PLAYED AN IMPORTANT ROLE IN TRIGGERING THE RECENT ECONOMIC CRISIS. THESE POLICIES INCREASED HOUSE PRICES AND THEIR VOLATILITY, AND REDUCED THE MOBILITY OF LABOUR, WITH NEGATIVE EFFECTS ON THE ECONOMY.

The OECD makes a number of recommendations for more efficient and equitable housing policies that contribute to macroeconomic stability and growth. These are reviewed in this article in relation to the UK market.

## House price volatility

Financial market liberalisation over the past 30 years has led to an expansion in the supply of mortgage loans and a significant reduction in the cost of borrowing. The OECD reports that lax banking supervision and consequently poorly underwritten mortgage contracts significantly reduced the credit constraints for many households, especially first time buyers, as it allowed households to rely more on debt to finance house purchase. Demand for debt-financed house purchase therefore increased significantly which left economies susceptible to volatile changes in house prices.

UK house prices have risen sharply over the last 10 years which is partly attributable to the low price elasticity of supply of new housing in the UK compared to other OECD countries. This means that the supply of housing doesn't change much in response to changes in house prices. Therefore, when housing demand rises it translates into larger increases in prices. The UK housing supply is constrained by physical land limitations and a relatively high population density, however the implementation of more efficient housing policies could help improve supply responsiveness.

The report finds a correlation between construction licensing procedures and supply responsiveness. According to data from the

World Bank, it takes 70 days to obtain a building permit in the UK, which is below the average of the 21 OECD countries analysed, but is still significantly higher than the USA where it takes just 5 days, or Germany where it takes 25 days. A streamlined construction licensing procedure and an easing of planning restrictions should increase the supply responsiveness and reduce house price volatility.

The OECD also suggests that tax systems could be improved so that they further incentivise landlords to fill vacant properties and undeveloped land. Residential landlords in the UK are eligible for six months council tax relief on empty properties after which the full rate applies. This period of relief could in theory be reduced or removed to help improve the supply of residential housing.



Also, commercial landlords in the UK have received concessions on 'empty rates' since April 2008, but this exemption will be vastly reduced this year, in line with OECD recommendations.

### Mobility of labour

The OECD explains that it is vital for workers to be mobile between sectors and regions if countries are to return to pre-crisis employment rates. In general, home owners tend to be less mobile than renters, and those who own their home outright are less mobile than those who have a mortgage. In 2008 over two thirds (68%) of UK households were owner-occupiers, although this has reduced from 71% in 2000. This high rate of homeownership would suggest that the mobility of labour within the UK is relatively low. However, of the 26

countries analysed in the report the UK showed a slightly greater mobility rate than average.

Transaction costs associated with moving home is one of the greatest barriers to mobility, but in the UK these costs are relatively low which should help the mobility of homeowners. Out of 33 OECD countries, the UK has the third lowest transaction costs as a proportion of property value at 4.3%, although these could still be reduced further.

The UK rental sector is smaller than in many countries, but the relatively lax regulation of the rental market may help the UK to achieve its above average labour mobility rate. The report suggests that countries such as the UK could further increase labour mobility by harmonising regulations across both the private and social rental sectors. Reducing regulations in the social sector may encourage mobility as social tenants would not be disadvantaged for moving into the private market. As of April 2011, local authorities will have the flexibility to charge social tenants up

to 80% of the market rate. This is a more flexible approach compared to the rent caps currently in place.

Increasing the availability of mortgage finance and products at higher LTV ratios could help boost labour mobility, but the OECD warns of the risks to the economy of doing so. However, if the market is susceptible to volatile price movements or bubbles, greater access to credit could reduce mobility if households fall into negative equity when prices fall. Households may then be unable to refinance their mortgage or unwilling to sell at a loss.

And the relatively inelastic supply of housing in the UK may contribute to immobility if regional differences in house prices are exacerbated.

The report suggests that governments should remove taxes favouring home ownership. Pre and post tax returns on housing should be in line with other forms of savings or investment. Housing investments should therefore be taxed as part of income tax, and on net imputed rental income. The benefits of ownership versus renting would narrow if this were to be implemented, and would therefore help the mobility of labour.

The OECD also warns that policies such as mortgage interest deductibility are inequitable without the taxation of imputed rents. Interest deductibility subsidises higher income households who would normally be able to purchase a home without it. In the UK mortgage interest deductibility for owner occupied properties was abolished in 2000, but still exists for purchases of a second home used for business purposes. Capital gains tax was increased for higher rate tax payers in June 2010 from 18% to 28% which brings it closer to the higher rate of income tax at 40%.

The OECD warns that when housing supply is constrained in the short run, as is the case in the UK, the provision of rental allowances such as housing benefit may do little to improve housing availability. It is argued that rent allowances are passed onto higher rents rather than improving housing conditions. This theory appears to have influenced forthcoming UK housing reform. From April 2011 the Government will introduce new absolute caps on housing benefit in order to constrain the cost of housing and attempt to make the system more equitable. According to the Welfare Minister, Lord Freud, since 2007 private rental market rents have increased by 15% overall, but by 25% for those on Housing Benefit. Under the new system it is believed that landlords will reduce rents in response to the cut in benefit payments.

### Conclusion

Overall, the UK housing market appears relatively well positioned to promote residential mobility and house price stability compared to other OECD countries. The supply of housing in the UK is unresponsive to changes in demand, which will put upwards pressure on prices, but this is as much a consequence of geographical limitations as poor housing policy. There is still room for improvement in some areas, although recently announced reforms are moving policy in the direction suggested by the OECD.

The full report - *Housing and the economy: policies for renovation* - can be downloaded from the OECD website [www.oecd.org](http://www.oecd.org)



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# MORTGAGE REGULATION

## - WHERE ARE WE NOW?

BY PAUL BROADHEAD, BSA HEAD OF MORTGAGE POLICY



THE MORTGAGE MARKET REVIEW (MMR) SEEMS TO HAVE BEEN UNDERWAY FOR SOME CONSIDERABLE TIME NOW. INDEED THE INITIAL DISCUSSION PAPER WAS PUBLISHED IN OCTOBER 2009 AND THE DIALOGUE HAS BEEN PRETTY UNRELENTING SINCE THEN. DEMANDING AND TIME CONSUMING THOUGH IT IS, IT IS NOT THE ONLY PROSPECTIVE REGULATORY INTERVENTION ON THE HORIZON FOR THE MORTGAGE MARKET.

### Arrears

It is worth taking a moment to reflect on where we have got to. Early in 2010 the consultation for the initial discussion paper closed and hot on its heels were detailed proposals on arrears processes and fees. While these proposals were mainly to provide clarification there was some difficulty in terms of implementing some of the rules, particularly relating to early repayment charges (ERCs).

### Approved persons

Also contained within the arrears paper were further proposals relating to the expansion of the approved persons regime for mortgage advisers. These proposals were broadly sensible, although I would contest the need to include lenders' own branch advisers within the scope of the proposals. Initially, the new approved persons regime was due to be implemented in the first quarter of 2011. Towards the end of last year the FSA decided to delay its

implementation for a couple of years (due to operational reasons and a reprioritisation of its workload) and it now expects that this will come into force in 2012/13.

### Responsible lending

Finally, in July, the paper on responsible lending that had been the subject of most speculation was finally published. It certainly contained the most controversial proposals to be tabled as part of the mortgage market review to date, including the prohibition of self certified mortgages and the effective end of fast track mortgages where income is not verified. The FSA also proposed that the lender would be made 'ultimately responsible' for affordability. The industry response resisting the proposals was strong, and united. Generally, I can see the reason why the FSA is going down this route, although it is the unintended and detrimental consequences of the proposals on the wider market, including existing or aspirant borrowers, that worries me most. It is clear that some mortgage holders, the

number of whom has been the subject of much debate, will not be able to remortgage, and other perfectly credit worthy people will not be able to get a mortgage at all.

I also have a fundamental concern that many of the proposals transfer responsibility away from the consumer and onto the lender. Whilst I accept lenders' responsibility to verify the application information and to have appropriate controls in place, it must be balanced with the capability of the customer to make sound financial decisions for themselves. The proposals as currently drafted do not achieve this balance and seem to be predicated on the patronising position that consumers need protecting from themselves, a view that I, and I'm sure the majority of borrowers, find insulting.

Recently HM Treasury has confirmed that the regulation of second charge mortgages will be transferred to the Financial Conduct Authority (FCA); the conduct of business regulator that will succeed the FSA. HM

Treasury also confirmed that the onward sale of mortgage books would also be regulated and that the FSA will tighten the regulations of the sale and rent back sector.

Further to this, we have also seen recent consultations on the transfer of consumer credit regulation from the Office of Fair Trading (OFT) to the FCA as well as a further paper on product intervention from the (current) FSA. If you have managed to keep up so far you could be forgiven for not raising your head from the trenches to see what is going on in other jurisdictions, ie Brussels and Strasbourg.

### The European dimension

Shortly to be published by the European Commission is a European Directive on Responsible Lending and Borrowing. It is expected to address many similar areas to the FSA review. The concern I have here is that it is similar - not necessarily the same. The Commission is keen to have a European Standardised Information Sheet (ESIS). The ESIS is expected to be similar - but not necessarily the same - as the Key Facts Illustration (KFI) currently provided under the MCOB rules. Clearly, this could mean costly changes for lenders which will result in little or no benefit to the borrower. The directive is also likely to focus on creditworthiness, affordability, advice, arrears practices and disclosure. Is this beginning to sound familiar?

It is not yet clear how prescriptive the directive will be. Certainly my view is that, if the Commission are committed to proceeding with a directive (and I am not convinced that the case for intervention has been made) based. This essentially

gives national authorities the right to determine how best to implement the changes in their own member states. Although, I will be careful what I wish for here as, I would expect, given the work undertaken so far on the MMR, that the FSA would gold plate the requirements for UK lenders.

As you will appreciate, there is much going on and yet we are still awaiting further proposals on interest-only mortgages, credit impaired borrowers, mortgage charges and fees amongst others, as well as an impact and cost-benefit analysis of the conduct of business reforms.

### A scattergun approach

Of concern is the lack of co-ordination and the scattergun approach taken by the regulator(s). There doesn't appear to be any detailed, reliable analysis of the cumulative impact (or cost) of the range of regulatory initiatives. Invariably, smaller firms are hit harder by the increased regulatory costs and proportionality is often overlooked by the 'one-size-fits-all' approach that is taken.

It seems apparent, to me at least, that both recently introduced regulations and the current proposed regulations tend to favour large, proprietary organisations. There is a risk that little account will be taken of organisational structure in terms of reacting to the recent crisis. On the definition of capital (a topic that my colleague Jeremy Palmer has written about before) the Basel

Committee treated mutuals only as an afterthought and even then the authorities initially tried to shoehorn the sector into the proprietary model, a model which has hardly proven itself to be the gold standard in recent years.

### A diverse marketplace

Competition and diversity is of vital importance to ensuring a sustainable and vibrant market, which offers appropriate choice for consumers. I don't believe that a mortgage market dominated by a concentrated group of lenders is desirable in the long term, nor would it meet the FSA objectives of ensuring a sustainable market for all participants and a flexible market that works better for consumers.

Returning to the care that one must take when wishing for something, if I was in charge of the FSA for a day, I would commit to carrying out a complete analysis of the enhancements made to the supervisory regime and the prudential changes. If these changes prove not to have addressed the consumer detriment that the MMR is attempting to, then, and only then, would I bring forward targeted rule changes to address the areas of detriment that persist.

With the clear focus on affordability, at both European and UK level, it is perhaps ironic that the regulatory bodies seem reluctant to assess the affordability of the industry to absorb the costs of all of this new regulation.



For more information, contact Paul at [paul.broadhead@bsa.org.uk](mailto:paul.broadhead@bsa.org.uk)

# MMR ON THE POLITICAL AGENDA

BY RACHEL WYLIE, BSA PRESS AND PUBLIC AFFAIRS MANAGER



THE BSA HAS CONSISTENTLY ARGUED THAT THERE SHOULD BE A FULL DEBATE ON THE FUTURE SHAPE OF THE MORTGAGE MARKET, PRIOR TO THE FSA PRESSING AHEAD WITH ITS PROPOSALS UNDER THE MORTGAGE MARKET REVIEW (MMR).

## Clear objectives

Some of the proposals could have a profound effect on the housing market, social mobility and aspirant homeowners. We believe the Government needs to provide a clear plan of their housing policy objectives, with the regulator facilitating the delivery of those objectives via a vibrant and diverse mortgage market based on a culture of responsible lending and borrowing.

We are therefore pleased to see the MMR creeping up the political agenda with a number of MPs raising concerns and asking questions in Parliament.

One of the critics of the FSA's proposals has been the Housing Minister himself, Grant Shapps MP. Speaking at the National House-Building Council's annual lunch in November, Shapps told delegates that the FSA's current proposals would prevent him from getting a mortgage.

## MPs raising concerns

Robert Syms, the Conservative MP for Poole, also has concerns. He secured a Westminster Hall debate in

January on mortgage regulation where he raised many issues the BSA has worries about. He had previously asked a number of Parliamentary questions on the MMR. In his debate, Syms gained support from John Woodcock, Labour/Co-op MP for Barrow and Furness, who highlighted that smaller lenders such as building societies were not responsible for the crisis and therefore should not be penalised by the FSA's broad-brush proposals. Syms argued that one of the important things about the proposals is not always to focus on the five big banks but to ensure that there is a diverse mortgage market that includes many smaller building societies.

Other backbenchers have been getting in on the act too. Stephen Gilbert, the Liberal Democrat MP for St Austell & Newquay, questioned the Housing Minister on the effect on the housing market of the responsible lending consultation. In his response the Minister said the MMR proposals "deserve wide debate based on the best possible evidence".

Harriet Baldwin, Conservative MP for West Worcestershire has raised her concerns on the impact of the MMR on small businesses and house prices, as has Marcus Jones, Conservative MP for Nuneaton. The Shadow Housing Minister, Alison Seabek MP, requested that records of the Housing Minister's discussions with the FSA and the Chancellor on the MMR be published.

PERHAPS IT'S TIME THE GOVERNMENT DEBATED THE FUTURE SHAPE OF THE MORTGAGE MARKET. THIS IS THE ROLE OF ELECTED REPRESENTATIVES AND WE WOULD URGE THE GOVERNMENT TO MAKE THIS DEBATE A PRIORITY.

It's clear that politicians have a keen interest in the MMR and what the outcomes will mean for their constituents. So perhaps it's time that the Government lead a debate about the future shape of the mortgage market. This is the role of elected representatives and we would urge the Government to make this debate a priority.

# A SUSTAINABLE MORTGAGE MARKET

BY SHEILA NICOLL, DIRECTOR, CONDUCT POLICY, FINANCIAL SERVICES AUTHORITY



WE HAVE HAD MANY CONSTRUCTIVE DISCUSSIONS WITH THE BSA AND ITS MEMBERS ABOUT THE MMR. INDUSTRY FEEDBACK REALLY MATTERS TO US IN HELPING INFORM OUR APPROACH.

We read criticism that the FSA seems determined to put in place a particular set of regulatory measures, irrespective of their impact on the economy and the market and irrespective of the views of others. I hope our engagement with you illustrates just how wrong that view is. We have benefited from many open and frank exchanges with the BSA and appreciate the opportunity we have had to discuss our thinking direct with BSA members. We *are* listening.

## Getting it right

As everyone knows, what we want is a mortgage market that is sustainable over the long term and that works better for consumers. Prudent lending should be the norm. What I'm sure none of us want is a return to some of the practices seen in the past. We want to put in place rules for the future that will constrain the significant tail of poor mortgage lending that we know took place. Getting it right now is essential to getting the market to a more sustainable position. It will also protect consumers from taking on mortgages they cannot afford and from all the adverse consequences that flow from that.

I know there is a view that there is no need for us to do anything as the market has self-corrected. Well - it is true that the market has moved back to much more

cautious levels. But with funding thin on the ground, it isn't surprising that what's available is used to support higher quality lending. As money comes back into the market, so firms will come under increasing pressure to consider riskier lending, focusing more on market share or margin than credit risk. We need to learn the lessons of the past.

WE WANT TO PUT IN PLACE RULES FOR THE FUTURE THAT WILL CONSTRAIN THE SIGNIFICANT TAIL OF POOR MORTGAGE LENDING THAT WE KNOW TOOK PLACE.

There is also a view that our work is unnecessary because arrears aren't as bad as first feared. Of course, any good news on arrears is welcome - but we need to remember that with interest rates at an all time low, the arrears burden for those in payment difficulties has lessened. And faltering house prices have removed an incentive for firms to take early proceedings. We have also seen firms - as we have been urging them to do - showing greater forbearance. But still long-term arrears continue to show a worrying increase. Even a modest rise in interest rates could lead to a significant increase in the number of families suffering financial distress.

## Impact on the market

There has also been considerable concern and speculation about the impact the MMR will have on the market. Until our proposals are final, of course, we are not in a position to properly assess their impact. I want to assure you that we will be conducting a comprehensive impact assessment, not just on each individual measure, but also on the effect of our proposals in the aggregate.

Until we arrive at the final package of measures, any assessment of the full impact is flawed. We will also be giving careful consideration to

appropriate transitional arrangements for existing mortgage borrowers. Our aim here will be to avoid disadvantaging those well able to pay their current mortgage.

And as we have said many times, we are not going to rush into change. It is really important that we take our time to get it right and also that change is introduced at an appropriate time for the market. We will also want to take account of expected European intervention on responsible lending and borrowing. And then there is the recently announced transfer of second charge loans from the OFT to accommodate.

So this year promises to be an interesting one. We look forward to continuing to work closely with BSA as we finalise our proposals.

# WILL THE MMR DELIVER FOR THE CONSUMER?

BY PAUL WINTER, CHIEF EXECUTIVE, IPSWICH BUILDING SOCIETY



FOR THOSE OF US WHO HAVE BEEN AROUND LONG ENOUGH TO REMEMBER THE LEAD UP TO THE INTRODUCTION OF MCOB IN 2004, THE CURRENT DEBATE OVER THE FSA'S MORTGAGE MARKET REVIEW BRINGS BACK MEMORIES.

Then, as now, there were howls of protest at some of the early proposals. I suspect the same orderly retreat from some of the more unpopular proposals will also take place this time.

The big difference though is that the current proposals come against the background of an economy just beginning to emerge from the worst post-war recession and what is at best a very fragile housing market. The danger of too restrictive

THE CURRENT PROPOSALS COME AGAINST THE BACKGROUND OF AN ECONOMY JUST BEGINNING TO EMERGE FROM THE WORST POST-WAR RECESSION AND WHAT IS AT BEST A VERY FRAGILE HOUSING MARKET

rules is that it could create further disruption to the housing market which as we know is vital to the growth of the economy as a whole.

I would like to state at the outset that sensible regulation is vital to the effective functioning of the financial services industry. However an over reaction to some of the issues, such as overly lax self-certification lending or 125% loan-to-value mortgages, risks creating real problems to

existing mortgage holders and acts as an even bigger barrier to first time buyers.

Looking at some of the key proposals through the eyes of the consumer let me consider some of the key themes:

## Affordability

As I mentioned earlier no-one wishes to see a return to the ludicrous income multiples seen at the height of the boom but we need to keep things in

perspective. I would imagine that the vast majority of the public stretched affordability to the limit when buying their first home or moving into their dream house. But the overwhelming majority did this with their eyes open knowing they would have to adjust expenditure elsewhere

- cutting out expensive holidays for example or reducing the number of times they visit a restaurant. All of these I believe are normal human behaviour. Should a prescriptive set of affordability rules really stop this happening to protect the few who overstretched themselves?

## Self-certification and the self-employed

Would you employ an accountant who didn't use all of their skills to ensure you paid as little tax as possible? An outright

ban on any form of self-certification could make it virtually impossible for the self-employed to get a mortgage.

## Interest-only mortgages

These mortgages do have a part to play in the market and certainly it is hard to see buy-to-let borrowers wanting to go onto a repayment mortgage. From other groups, say for example the newly qualified young professional, a period of interest-only can be a low risk approach to keeping payments low for a short period.

## Lending into retirement

With the abolition of the compulsory retirement age I'm not sure how lenders and borrowers are going to deal with this issue. If an applicant says they intend to work until they are 70, can we take it at face value? After all a borrower who is say 30 years of age and in full time employment may decide after a couple of years to change careers. They will do this understanding their mortgage responsibilities. Why can someone of 60 not be given the same respect?

I know that the building society sector will be working with the FSA to ensure that any new rules are both effective and proportionate. We do, though, all have to consider where the consumer fits into all of this.

# PROPORTIONALITY IS KEY FOR THE MMR

BY LYNNE FOREMAN, HEAD OF REGULATORY RISK,  
YORKSHIRE BUILDING SOCIETY



THE MORTGAGE MARKET IS COMPLEX - CONSUMERS RANGE FROM THE FINANCIALLY ASTUTE TO THE FINANCIALLY VULNERABLE AND THERE IS NOT A 'ONE-SIZE-FITS-ALL' SOLUTION. THE FSA MUST REMEMBER THE NEED FOR PROPORTIONALITY WITHIN THE WORK IT UNDERTAKES, PARTICULARLY THE MORTGAGE MARKET REVIEW (MMR).

Borrowing on mortgage is, from a consumer perspective, one of the safer forms of borrowing (eg versus unsecured loans, credit card borrowing, overdrafts etc.) and we support the need for sustainable home-ownership.

## Striking the right balance

We fully support the FSA's stated intention to rebuild the mortgage market to ensure sustainability and make sure responsible lending delivers fair consumer outcomes. But we must learn from the experience of implementing MCOB regulations and retain the 'good bits' whilst addressing potential weaknesses.

We must also be mindful of the fragile economic environment in which we find ourselves. It is essential that the customer outcomes of MMR deliver the 'fairness' piece but do not inhibit customer choice and access to the mortgage sector.

The FSA's Treating Customers Fairly agenda has already driven changes within many firms with regards to the focus on the consumer and on fair outcomes. Customer fairness is a priority on the agenda of most Boards; this should be acknowledged and reflected by the FSA in the proportionality of their approach to the extent that further change is required.

## Market changes should be assessed

Many lenders have already reviewed their policies and approach and imposed much stricter criteria and processes to address the issues that were prevalent in the market prior to the financial crisis. The regulators should recognise that lenders have taken these steps and not inhibit the ability of borrowers to borrow from UK

THERE ARE COST IMPLICATIONS OF THE PROPOSALS - FOR EXAMPLE THE APPROVED PERSONS REGIME FOR MORTGAGE ADVISERS AND, ALTHOUGH THIS IS CURRENTLY DEFERRED, THIS TOGETHER WITH OTHER PROPOSALS WILL ULTIMATELY MEAN THAT MORTGAGE COSTS INCREASE AND THIS INCREASE IS MET BY THE CONSUMER

banks and building societies by making rules even tighter - for example that affordability should be assessed only over a 25 year mortgage term.

Much of what the FSA is proposing in the MMR is what mainstream lenders have done before - for example in the case of income verification, the industry has always had processes and controls in place to check and validate income.

Yes these processes did differ between lending types (prime, self-certification and credit repair for example) but none the less they were there. It is in nobody's interest for customers to default on their monthly payments.

FSA arrears statistics show that the overwhelming majority of mortgage borrowers in the UK have been able to continue to make their mortgage

repayments. Low interest rates have clearly helped, but it does demonstrate that in the UK, the vast majority of building societies and other mainstream lenders have acted responsibly.

There are cost implications of the proposals - for example the approved persons regime for mortgage advisers and, although this is

currently deferred, this together with other proposals will ultimately mean that mortgage costs increase and this increase is met by the consumer.

In what is being proposed it is likely that we will see 'over-regulation' and a situation where innovation in the market is stifled and a proportion of society has no access to the mortgage market.

# LENDING TO **FIRST TIME** BUYERS

BY ADRIAN COLES, BSA DIRECTOR-GENERAL



ON A 'MEET THE PEOPLE' VISIT TO LEICESTER IN JANUARY THE PRIME MINISTER SUGGESTED THAT MORE NEEDED TO BE DONE TO HELP PEOPLE ONTO THE HOUSING LADDER.

Mr Cameron said -

*"There is a problem here because we all know one of the ways we got into trouble as a country was we were allowing banks to lend to people sometimes 120% of the value of the property they were buying and sometimes six or seven times what they were earning.*

*"That was unsustainable so we were encouraging people to buy flats and houses they could not afford and then they were going into negative equity and left with a real problem. In a way the pendulum now has almost swung too far the other way... we do not want another housing boom where the prices rise again out of people's reach, but the housing market is a key part of the economy. You need a housing market where people are able to sell, buy, move to different parts of the country, or go in search of that job they want or reunite their family or whatever it is. The housing market has become very stuck and we have got to get it moving again and so a proper conversation with the banks and the building societies that stops the pendulum going too far the other way is important. What we want is a market that is moving, but not the unsustainable rise in prices. That is what we are trying to deliver."*

These are certainly sentiments that BSA members would support, and we are playing our role in the meetings that have been called by Housing Minister, Grant Shapps MP, since the Prime Minister made his remarks.

We want to look at how best to help first-time buyers. It is certainly the case, as the PM suggested, that banks and building societies became more cautious during the recession, making it more difficult for

some borrowers to obtain loans. Despite this many mutuals have good products especially targeted at first time buyers. However, lender caution is by no means the only factor inhibiting activity. Other factors influencing lenders' (including building societies' and other mutuals') willingness to lend are at least as significant and include -

- The considerably more onerous and restrictive rules proposed by the FSA's Mortgage Market Review.
- The new Building Society Sourcebook, introduced by the FSA, that limits the amount of higher LTV lending that building societies can undertake.
- The need to generate additional capital to meet new regulatory requirements, and the especially higher amounts of capital now required for high loan-to-value ratio lending.
- The availability of funding - severely constrained in both the retail and wholesale markets over the last three years.
- The negative view taken by the credit rating agencies on institutions that lend what the agencies would regard as "too much" on a high loan-to-value ratio basis - ie the typical basis required by first-time buyers.
- The need to get the rest of the housing market moving if vacant dwellings are going to be available for first-time buyers to buy.
- The wide range of demand side issues relating to potential borrowers' willingness to borrow in an uncertain economic environment - the perceived threat of unemployment, for example, or interest rate increases.

The short-term prospects for the housing market look weak; longer term we need to develop solutions to these issues before the market can move forward.

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# TOO IMPORTANT TO FAIL

BY CHRIS LAWRENSON, BSA HEAD OF LEGAL SERVICES



REGULATORY REFORM IS HIGH ON THE AGENDA OF THE FINANCIAL SERVICES INDUSTRY AND THERE IS NO SHORTAGE OF IMPORTANT SUBJECTS TO CONSIDER. WE ARE CURRENTLY EXAMINING CONSULTATIONS OR DISCUSSION PAPERS ON THE FUTURE SUPERVISION OF CONSUMER CREDIT, ON THE POSSIBILITY OF GREATER PRODUCT INTERVENTION BY THE REGULATOR, AND ON THE OVERALL ARCHITECTURE FOR THE NEW REGULATORY REGIME.

Certain matters are high on the BSA's own agenda. We strongly support the Government's commitment to corporate diversity because we are convinced that, in the interests of consumers and business alike, diversity needs to be integral to both prudential and conduct of business regulation. We explained the reasons in our response last Autumn to the Treasury consultation and continue to work with authorities to help ensure that principle is put into practice. Another key priority for the sector is that the regulators should behave proportionately; in particular, that they should not follow a 'one-size-fits-all' approach that, for example, disregards the needs of smaller businesses. We welcome the assurances on these matters set out in the Treasury's recent consultation *Building a Stronger System*.

## FCA as "consumer champion"?

We also believe that it is essential in the interests of consumers and business that both prudential and conduct of business regulators should not only be strong and effective, but also fair and impartial. So far, we are not convinced that the planned accountability provisions will be robust enough. For instance, it is naturally right that the Financial Conduct Authority (FCA) should have a fundamental consumer protection objective, but the characterisation of the FCA as a "consumer champion" is contrary to the role of an impartial conduct of business regulator.

For example, how can the FCA be a "consumer champion" (ie mandated to one side only) when conducting enforcement proceedings where the firm in question has the right to a fair hearing? In its February 2011 report, the Treasury Select Committee described the proposal as "inappropriate, confusing and potentially dangerous". The consumer champion label, still retained in the

latest Treasury paper, is likely to be a recipe for difficulty, and even confrontation, for years to come, unless it is balanced by a statutory requirement of fairness and impartiality.

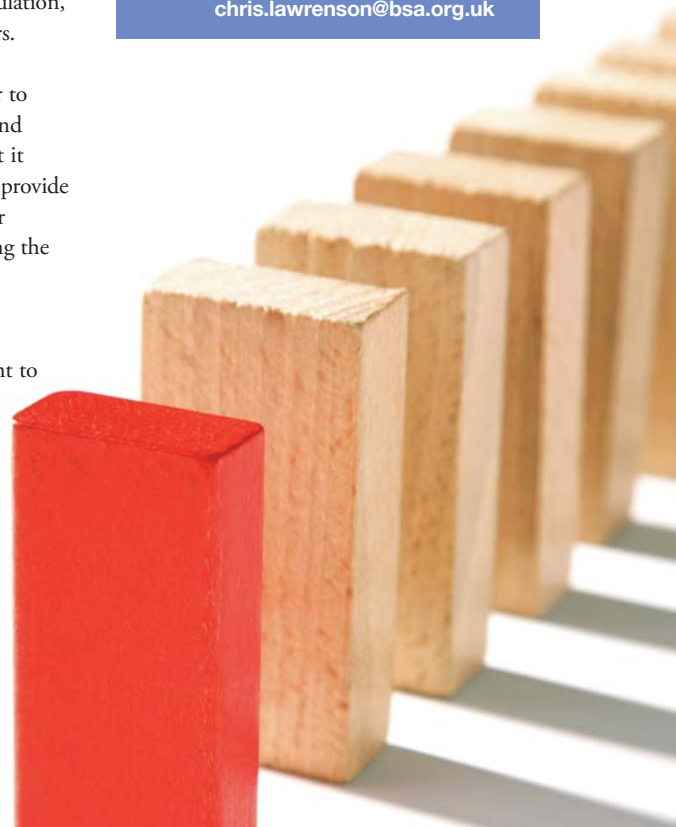
## Cost and accountability

Even when all the points of principle are ironed out, the greatest challenge for the new regime will remain; namely - *to work effectively*. We must not underestimate the practical difficulties of sharing out the FSA's responsibilities among a number of new regulators and other bodies; notably, the FCA and the Prudential Regulatory Authority. Costs need to be contained and duplication must be kept to a minimum. The Treasury Select Committee expressed concern at the lack of consideration of the cost of regulation, which is ultimately borne by consumers. There is probably no way of averting duplication of regulatory visits in order to supervise firms from both prudential and conduct of business points of view. But it should be feasible for the regulators to provide firms with a 'single gateway' such as for approvals, reporting, matters concerning the Handbook etc. And, in these days of technology, the regulators should also be able to share most 'back office' functions. More broadly, a commitment to the simplification of UK consumer law and regulation - in practice as well as words - would greatly benefit future conduct of business regulation.

The BSA is working closely with the authorities, consumer bodies and a range of other trade sectors on the high-level policy issues. We have also set up a practitioners' working group to make sure we are well placed to help and advise the authorities on the practicalities of making the new regime work effectively. We often hear about firms that are "too big to fail" but, when it comes to regulatory reform, one thing is certain - after the experiences of the previous regulatory arrangements, the credit crunch in 2007 and the considerable pain for the country ever since, the new regulatory regime is too *important* to fail.



For more information, email **Chris** at [chris.lawrenson@bsa.org.uk](mailto:chris.lawrenson@bsa.org.uk)



## INNOVATION IN SAVINGS MANAGEMENT

JOHN WARDEN, OPERATIONS DIRECTOR AT NEWCASTLE BUILDING SOCIETY



THE NEED FOR BUILDING SOCIETIES TO DEVELOP NON-INTEREST INCOME STREAMS IS SOMETHING THE NEWCASTLE HAS BEEN INVESTIGATING ACTIVELY FOR SEVERAL YEARS.

It led the Society, which I joined last year, to explore some more innovative areas. As a result we now issue prepaid cards, provide complete systems to smaller societies, and for more than seven years, we have provided a white-labelled internet savings service to a variety of building societies and banks.

### Innovation - entirely new or incremental?

In the past, we understood innovation to mean doing something completely different and new. More recently we've been channelling our efforts towards refinement and improvement, bringing in new and improved processes and capability. In savings management that means being faster in taking a new client to market, providing a quicker turnaround on new product development, and ensuring the product range is a fully integrated multi-channel offer; Internet, postal and phone, one which is integrated with the client's system.

Interest in outsourced savings management has always come to us from both established players and new entrants. These sources of interest are not changing, but we do expect to see changes in the retail savings market this year for a variety of reasons,

including more new entrants to the marketplace and the repayment of the Special Liquidity Scheme.

Within our savings management business we've made changes that enable us to respond more quickly to changes in demand for our services - by putting the emphasis on "tailoring" rather than "bespoking" client requirements. This allows us to plug our broad capability quickly and seamlessly into a client's existing offer.

You might expect after many years we'd be pretty slick at responding to our savings management clients. While we are, we also recognise that regular innovation in the detail will continue to deliver improvements.

## USING WHAT WE HAVE TO THE FULL

PHIL GRAND, MANAGING DIRECTOR, NEWCASTLE STRATEGIC SOLUTIONS LTD - SAVINGS



WE KNOW OUR FULLY OUTSOURCED SAVINGS MANAGEMENT SERVICE WORKS EXTREMELY WELL FOR CLIENTS WITH REQUIREMENTS FOR RETAIL FUNDING, RANGING FROM SEVERAL HUNDRED MILLION PER ANNUM TO SEVERAL BILLION.

However, not everyone has funding requirements of that magnitude. Although one thing all our clients do want, irrespective of size, is to transfer the operational burden of implementing and managing all or part of their savings portfolio. This allows them to focus on product design and price.

Several years ago, one of our innovations was to develop an Internet client funding system called Client Net tailored to the needs of Solicitors. It works extremely well, providing them with an internet service to push funds from their own client

account into designated interest bearing client accounts held at the financial institution for whom we set the service up.

Because it is almost entirely self service, our clients enjoy a source of funding, which is both low-cost and extremely sticky, for a very low administrative cost.

It works for the building society clients who use it to raise funds upwards of £10m. We'd be forgiven for overlooking this service as it is so simple and quick to implement and operate. However, the value it brings to our clients means it plays an active part in contributing to the £5bn we currently have under management for clients.

On our own Society balance sheet we want a diverse range of retail products with different dynamics. The same is true of the product range we have in place for our outsourced savings management business, which in turn provides options for our clients to diversify their own funding sources at a time of greater challenge and volatility.



# BSA Annual Conference

## 4&5 May 2011 | ICC Birmingham



*This year's conference is hugely relevant to those observers of the UK retail banking scene who are keen to work out where markets and institutions are headed.*

We look at how the external environment - whether it be financial, business, economic, regulatory, political or consumer - is shaping the way in which mutuals operate, and survey the impact that the new banks might have at a time of unprecedented discussion about the structure of UK banking. In addition to technical sessions and wide-ranging debates, we provide inspiring examples of mutuals taking the initiative, and making things happen.

The range of speakers is as impressive as the range of subjects covered. We have senior commentators from the worlds of business, politics, and the media. There are - at the last count - 18 chief executives, chairmen, founders, and editors; the views you will hear at the conference come right from the top! And we have a really good business exhibition and a networking programme including:

- welcome reception, sponsored by Coventry Building Society
- gala dinner, sponsored by Sun Life Direct, part of AXA Wealth
- breakfast with Deloitte
- day one - networking lunch, sponsored by Allen & Overy and Genworth Financial
- day two - networking lunch, sponsored by Legal & General

Find out more and register online at  
[www.bsaconference.org](http://www.bsaconference.org)

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# For maximum risk protection, here's something that ticks all the right boxes.

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