

Support for Mortgage Interest - Informal Call for Evidence Response by the Building Societies Association

1. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 47 UK building societies. Mutual lenders and deposit takers have total assets of over £375 billion and, together with their subsidiaries, hold residential mortgages of over £235 billion, 19% of the total outstanding in the UK. They hold more than £250 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for 34% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.
2. We welcome the opportunity to respond to the call for evidence on Support for Mortgage Interest (SMI). The BSA has been calling for a review of SMI for some time now in letters to the Chancellor ahead of Budget statements, to the Treasury Select Committee during its inquiry into mortgage arrears in 2009 and 2010 and in our report 'A joined up approach to helping mortgage borrowers'¹.
3. In the current economic environment, SMI for many claimants is a critical payment, that is often the difference between repossession and remaining in their homes. The DWP impact assessment published in August 2010² found that 225,000 customers were in receipt of SMI as at November 2009. This is significantly more than the number of customers assisted under other Government support schemes. At Q1 2011, 2,621 homeowners were accepted under Mortgage Rescue³ and far fewer placed on the Homeowner Mortgage Support Scheme, which has now closed to new customers.
4. We see SMI as an important part of the overall 'safety net' for borrowers experiencing financial difficulties, but we also recognise the challenge that it needs to continue to demonstrate its effectiveness and provide value for money to the Government.
5. We believe that many of the proposals are worthy of further consideration. However, the Government must ensure that changes are only implemented following robust analysis and an impact assessment. Of particular concern to the BSA is the removal of direct payments to the lender, as there is a risk that rather than empowering borrowers to take control of their finances it could instead result in increased levels of mortgage arrears.

Executive Summary

- We agree that in certain circumstances SMI should be recouped from long term claimants. However, there should be certain claimants who would be exempt from this, such as those borrowers that are unlikely to be in a position to seek employment and where SMI is providing a level of independence that the claimant may otherwise may not have.
- Placing a charge on the property would be a good way of recouping SMI payments from long term claimants.
- However, we disagree that using a charging order via a county court claim is the right way to do this. A better approach is via a voluntary charge, which registers the

¹ http://www.bsa.org.uk/docs/publications/helping_mortgage_borrowers.pdf

² <http://www.dwp.gov.uk/docs/support-for-mortgage-interest.pdf>

³ <http://www.communities.gov.uk/publications/corporate/statistics/mortgagerescuestatisticsq12011>

interest of DWP. This process would also give the customer the opportunity to seek independent advice on whether to continue to receive SMI with a charge on their property, or seek advice on alternative options. It also makes it clear to the consumer they have an option not to proceed by not agreeing to the charge.

- The BSA strongly believes that the Government should absolutely not move away from the Mortgage Interest Direct (MID) scheme. The current system works exceptionally well and ensures that payments are used as intended.
- We recognise the Government's desire to empower the claimant in managing their finances, which would also be in line with the process under Universal Credit. However, where the borrower is under financial pressure, there could be a risk that the payment is used for other purposes, be that to pay other creditors who are making more persistent demands for payment, or to subsidise household expenditure. In doing so the claimant is increasing the risk of losing their home, which is the very outcome SMI aims to avoid.

Putting a charge on property

Question 1: Do you think payments for support for mortgage interest should be recouped from claimants who are in receipt of help on a long term basis?

6. Yes, we agree that in certain circumstances SMI should be recouped from long term claimants. However, there should be certain claimants who would be exempt from this, such as those borrowers that are unlikely to be in a position to seek employment and where SMI is providing a level of independence that the claimant may otherwise may not have. For example, it may assist the claimant to purchase a property adapted to their needs.

7. Where SMI is expected to be recouped from the claimant, DWP will need to ensure it has adequate systems, controls and processes to review the circumstances of the claimant to agree a repayment plan which is suitable for that claimant. A one size fits all approach would be inappropriate.

Question 2: What period of time would represent a long term basis? For example, two years?

8. We agree that two years would be a suitable cut off point. We recognise that in the current financial environment individuals may find that obtaining new employment takes longer than in a more buoyant market. However, on the basis that the rules should be fit for purpose for the majority of claimants across the economic cycle, we consider two years to be a suitable cut off point.

Question 3: What are your views on the idea of recouping support for mortgage interest payments from long-term claimants through a charge on their property?

9. Placing a charge on the property would be a good way of recouping SMI payments from long term claimants.

10. However, we disagree that using a charging order via a county court claim is the right way to do this. Particularly where SMI continues to be paid, for example those claimants in receipt of Pension Credits. In these instances there would be no fixed amount on which a claim could be made (as it was still being paid there is no debt to 'crystallise'), therefore obtaining a charging order would not be possible.

11. Furthermore obtaining a county court judgment and then a charging order would imply there is a debt which has gone unpaid. This is not the case, it is a benefit the claimant is eligible for which they agree to repay at a point in the future. This is an important distinction.

12. A better approach is via a voluntary charge, which registers the interest of DWP. This process would also give the customer the opportunity to seek independent advice on whether to continue to receive SMI with a charge on their property, or seek advice on alternative options. It also makes it clear to the consumer they have an option not to proceed by not agreeing to the charge. Again, in the context of a charging order, this would be forced upon them and they would not have the opportunity to reject this approach.

13. DWP will also need to consider how a charge would work where the property is not entirely owned by the claimant, for example shared ownership properties. Consideration will need to be given as to whether the charge is based on the percentage of the property owned. This will need to be considered carefully otherwise these claimants could be paying back proportionately more than claimants who own 100% of the property.

14. Once the property is sold and the charge is enforced, DWP will also need to consider how they will deal with shortfalls should there be insufficient equity to repay the sums due, following the sale of the property. Would DWP intend to seek recovery of the debt via the courts or come to a voluntary arrangement with the claimant? In situations where the property is sold due to the death of the claimant, DWP will need to have a clear policy on whether a claim is made on the deceased's estate for the recovery of the sums due.

15. We recommend DWP undertakes detailed analysis of the impact of this and the practical implications.

Question 4: Are there other ways that Government could recoup or reduce the cost of long-term SMI claims?

16. In our view Government should consider the individual circumstances of the claimant to ensure that homeownership remains right for them. It could be that for some long term claimants, downsizing or exiting homeownership altogether may be a more appropriate solution to their needs, rather than the continued payment of SMI.

17. Government could also consider repaying the outstanding mortgage balance, rather than continue to pay SMI. This may be appropriate in the case of claimants in receipt of Pension Credits, where the remaining mortgage balance is small and therefore repaying this in full with a lump sum SMI payment, may reduce the overall cost. DWP could consider protecting this payment via a charge on the property, therefore the payment is still recouped at some point, but the costs associated with ongoing payment may well be reduced.

18. We have not sought to provide a detailed breakdown of the potential cost savings of this approach as our data set is limited. Whilst we can model the financial impact of repaying the loan, we have no data relating to the internal costs DWP incur when managing an SMI claim for example. In our view it is important that these are factored into a cost benefit analysis on this proposal and therefore recommend DWP consider this further with a complete set of data.

Question 5: Should there be a fixed period of grace before the charge is applied?

19. Yes. This should only apply to long term claimants, therefore after 2 years.

Question 6: Once it is applied should it relate to the total value of the support provided?

20. The BSA view is that it should only apply to the payments that continue to be made after 2 years. This will ensure the charge only relates to long term claimants and not to all claimants.

21. We also believe it is important to note that claimants are entitled to some assistance from the government and it is important that SMI continues as a state benefit. Recouping the total value of the support from longer term claimants would imply that they were not eligible for state support on a shorter term, as other claimants are. To ensure fairness and

consistency, SMI payments should only be recouped once the claimant becomes a 'longer term' claimant.

Question 7: Should the proposal to put a charge on a property be extended to cover all recipients of SMI, effectively abandoning the two year limit in place for claimants who receive SMI with Jobseeker's Allowance or its future equivalent with Universal Credit?

22. It should only apply to the payments that continue to be made after 2 years, as per our response to question 6.

The standard interest rate

Question 8: Do you think that the current method of calculating the standard interest rate is the fairest and most effective method?

23. The current method is a better metric than that used previously. However, the fairest and most effective method would be to calculate SMI based on the rate being charged by the lender.

24. The table below is analysis undertaken from a limited cross section of BSA members in September 2010. The data does not represent all BSA members and is therefore for illustrative purposes. However, it aims to give an indication of the expected impact of the rate change in October 2010.

25. The table shows the impact of the rate change on existing SMI claimants.

SMI rate	Covers payment in full	Cover payment in part with shortfall from the borrower	Covers payment in part, borrower unable to make up shortfall
6.08%	56%	37%	7%
3.65%	21%	15%	64%

26. This analysis demonstrates that the current rate is not entirely effective in ensuring the full amount of mortgage interest is paid by SMI. In our view this would merit further detailed analysis of the impact of matching the SMI payment to the rate charged on the mortgage.

27. We recognise there may be practical difficulties but it is an option that should be seriously explored.

Question 9: Is there another method of calculating a standard interest rate for SMI that may be fairer or more effective?

28. As per our response to question 8, SMI could be paid at the rate being charged by the lender.

Question 10: Should any action be taken in respect of the treatment of 'excess SMI' payments – if so, what?

29. To take action to reclaim the excess SMI, would involve calculating the interest rate charged by the lender for each individual claimant. If this was taken forward it would support a change to calculating SMI on that basis to begin with, as the administrative work needed to set this up for refunds, may as well be used to pay SMI in this respect from the outset.

30. Assuming the standard rate remains in place, we believe it would be simpler to maintain the current process, where the excess payment is used to repay the capital or held in reserve to counter any increase in the mortgage payments.

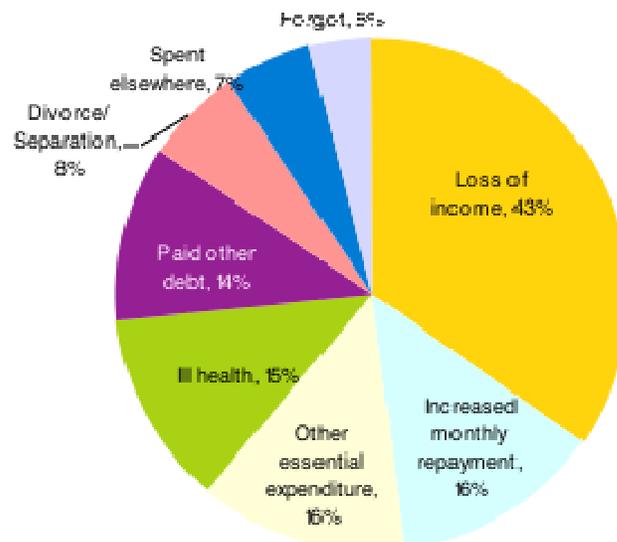
Mortgage interest direct

Question 11: Do you think that it is the right policy to move away from the Mortgage Interest Direct scheme for most claimants?

31. The BSA strongly believes that the Government should absolutely not move away from the Mortgage Interest Direct (MID) scheme. The current system works exceptionally well and ensures that payments are used as intended.

32. We recognise the Government's desire to empower the claimant in managing their finances, which would also be in line with the process under Universal Credit. However, where the borrower is under financial pressure, there could be a risk that the payment is used for other purposes, be that to pay other creditors who are making more persistent demands for payment, or to subsidise household expenditure. In doing so the claimant is increasing the risk of losing their home, which is the very outcome SMI aims to avoid.

33. Research conducted by the BSA in 2009⁴ showed that 38% of borrowers in arrears cited financial problems and expenditure events as the cause of the arrears. This is broken down further in the graph below, which shows that a significant proportion had other essential expenditure, paid other debt, or spend what money they had on other items.



Respondents could choose more than one response, so percentages add to more than 100%.

34. This in our view, shows that there is a significant risk that SMI would not be used as intended, increasing borrowers' risk of further arrears, or ultimately repossession.

35. The assessment of MID conducted in 1995⁵ indicates that the majority of claimants were happy with the payments being made directly. We recognise that consumer attitudes may have shifted since then, but there is no new evidence on which to robustly counter this view. We strongly believe that Government needs to seek views of consumers through robust research methods to ensure that the views of SMI claimants are taken into account. We are concerned that Government may move away from MID on the basis of an assumption of what consumers want.

36. Government would also need to consider carefully how the 1991 agreement between Government and lenders would be affected. This agreement aimed to ensure that lenders would not seek repossession where SMI met the mortgage interest due in full. There is a

⁴ BSA Research: [Understanding mortgage arrears 2009](#)

⁵ <http://research.dwp.gov.uk/asd/asd5/ihr/ih005.pdf>

concern that this agreement may be affected by the removal of MID, as the lender would no longer be aware that the borrower is in receipt of SMI.

Question 12: If we move away from paying support for mortgage interest by Mortgage Interest Direct, in what exceptional situations should claimants have their mortgage interest payments made direct to the lender and what criteria could be used to determine when this should happen?

37. Whilst we do not agree that MID should be removed, if it is despite our strong objections, then it must be re-instated where the claimant is already in arrears when SMI is paid, or when they fall into two months arrears during the period of the claim.

38. This will ensure that the payments are made to the lender and will help reduce the risk of repossession at the earliest possible opportunity.

The treatment of home improvement loans

Question 13: Do you think that the Department should move to a simplified approach for home improvement loans, subject to a cap on the amount of loan on which interest is payable?

39. Yes, a simplified approach would be preferable.

40. We would also support a review to expand the payment of SMI to cover loans for any purpose, including second charges. In our view it is illogical that SMI is available solely for the first charge mortgage, when the property could be repossessed by a second charge lender.

41. Government could consider expanding the proposal to place a charge on the property. Borrowers who may not be eligible for SMI, could still be provided with support, but with a charge placed on the property from the outset. This will help to reduce the risk of them losing their home, with the Government's interest protected with the charge. We believe DWP should consider the merits of this further.

Linking rules

Question 14: Do you agree that the 12 and 52 week rule should be retained for SMI purposes?

42. We agree that the 12 and 52 week rules should be retained.

Question 15: Do you agree that certain other linking rules should no longer apply as a simplification measure flowing from the introduction of Universal Credit?

43. Yes, we agree that other linking rules should no longer apply.

44. We would also support a further review as to whether SMI could be expanded to apply to those who may have received a reduction in income rather than a complete loss of income. In the current economic cycle there are a significant proportion of consumers who have seen a cut in overtime payments or have moved from full to part time work in order to stay in employment. In these instances, there is little to no assistance available to these borrowers. This is not necessarily fair as they have remained in employment.

45. In such instances SMI could be linked to the tax credit system, maintaining an incentive to stay in work, whilst providing support to ensure the mortgage continues to be paid and the risk of the property being repossessed is reduced.

Time limiting

Question 16: Should certain categories of claimants, for example lone parents and people with a disability, moving onto Jobseeker's Allowance (or the equivalent within Universal Credit) be exempt from time-limiting?

46. This would very much depend on whether the Government intends to take forward the proposal to recoup payments from longer term claimants. If the Government goes ahead and recoups payments from claimants who have been in receipt of SMI for more than 2 years, as suggested, then we see no reason for having a time limit on claims at all.

47. We recognise the argument that a time limit helps to ensure that claimants are clear they should be seeking to return to work, but having a charge placed on their property, if they continue to claim after 2 years may well act as an incentive to do so. More importantly it would also ensure that the rules were fit for purpose, despite the economic cycle, recognising that returning to work within 2 years in a depressed labour market, may not be realistic.

Question 17: Should there be a limit on the number of times a claimant can access two years of SMI?

48. Imposing arbitrary limits is difficult as this will very much depend on the circumstances of the claimant and the current economic conditions. For example a claimant may be in receipt of SMI for 6 months, move back into work, only to be made redundant 6 months later and therefore eligible for SMI once again.

49. That said, if the Government decides to move to a policy of recouping payments from longer term claimants, not having a limit could see an element of 'gaming' to ensure that it never gets to the point of payments being recouped. It is impossible to say what the likelihood of this occurring would be, but we would recommend the Government conducts further analysis on this when considering the proposal to recoup payments.

Waiting period and capital limit

Question 18: Have either of these two measures (13 week waiting period or £200,000 capital limit) been effective in reducing the likelihood of repossession? Where possible, please supply evidence to support your response.

50. Feedback from our members suggests that, reducing the waiting period from 39 weeks to 13 weeks has been particularly effective. At the point SMI is received claimants will have a maximum of 3 months arrears, compared to a maximum of 9 under the 39 week rule. This provides the lender with a greater number of options in terms of forbearance and ensures the financial situation is much easier for the claimant for manage.

51. However, it is very difficult to assess the impact of the changes to SMI in isolation as there are a number of other variables, introduced at around the same time which either individually, or collectively, will have had a impact on repossession rates. These are detailed below:

- Changes to FSA regulation (Mortgage Conduct of Business Rules, Chapter 13), which sets out the rules lenders must follow when dealing with a customer in arrears
- Mortgage Pre-Action protocol, which sets out the requirements that lenders must satisfy for the court to grant a repossession order
- Mortgage Rescue and Homeowner Mortgage Support, Government schemes designed to assist people with financial difficulty and prevent repossessions
- Preventing repossession fund, which allows local authorities to provide assistance to help people manage arrears

- Government agreement with major lenders to not seek repossession for 6 months following payment difficulties
- Investment in and the promotion of debt advice for people experiencing financial difficulties. This also includes the DCLG preventing repossession campaign.
- Investment in court desks, providing borrowers with assistance on the day of their repossession hearing
- Reduction in the Bank of England Base Rate to 0.50%

52. SMI will have been a key component of the package of measures that were introduced.

General

Question 19: Do you have any suggestions for options for SMI in the medium and long term that have not been covered elsewhere in this document?

53. We have no further suggestions.

Contact

54. This response has been prepared by the BSA in consultation with its members. Queries should be directed to Victoria Barnard (Victoria.barnard@bsa.org.uk)