



## **AFB response to 'Homes for the future: more affordable, more sustainable' Housing Green Paper**

This response is submitted on behalf of the Association of Finance Brokers (AFB). The AFB is the trade association representing intermediaries operating in the secured loan (second charge mortgages over residential properties) industry. Our members hold insurance permissions with FSA.

The AFB represents brokers who are responsible for approximately 75% by volume and value of secured loans in the intermediary channel. Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product from within their panel of lenders to meet the individual consumer's loan requirements. Our members also provide access to associated protection products such as payment protection insurance.

### **Summary**

We welcome the opportunity to respond to the consultation. Whilst the paper posed no specific questions on the area of the mortgage market, we felt that further comment and discussion was required and therefore submit this response.

The Green Paper covered many areas, and we have at this time limited our response to the section around the mortgage market. In particular, we would like to highlight our thoughts on long-term fixed rate mortgages.

### **Value of Advice**

AFB passionately believe in the value and importance of advice for consumers. We note that the Green Paper acknowledges that FSA's Product Sales Data shows that 58% of mortgage business is sourced by intermediaries; we would add to this that our own research suggests that 71% of mortgages are sourced via intermediary when considering all mortgage products, including non-FSA regulated arrangements such as buy-to-let mortgages.

We are pleased to see the DCLG also acknowledge the complexity and choice of mortgages available. An intermediary's primary focus is to ensure their client secures the most suitable loan from all those available across the market. Clearly suitability for a mortgage will depend on interest rate levels,

including anticipation thereof, personal circumstances, attitude to risk and ability to repay the loan. We believe that intermediaries do provide the 'high quality information and advice' commented upon in the report.

Further it is because of the work of intermediaries that the UK mortgage market is recognised as the most 'complete' in Europe. Intermediaries as the agent of the client, are a positive competitive force so keeping lending products, and rates, competitive. We are a force for innovation and market development.

Our members operate across the entire socio-economic range. First time buyers will seek out good mortgage advice as much as those with multi-property buy-to-let mortgage portfolios. Our firms advise on equity release, but also simpler products.

The work of our members supports a fluid employment market by advising on matters such as the renting of a property where one family member may be working whilst maintaining a family home in a different part of the country.

### **Remuneration Methods**

AFB also strongly believe in both choice and accessibility of advice for all. As part of this choice we expect firms to work on a variety of remuneration methods, which on some occasions will include remuneration by procuration fee. We would like to note that for an intermediary to define themselves as 'independent' they are obliged by the Financial Services Authority (FSA), the UK's statutory financial services regulator, to offer a consumer the opportunity to pay by fee for their advice and receive any procuration fee by refund, thus alleviating any potential perceived bias. However, we feel that the choice to pay by procuration fee is crucial in making advice accessible to the maximum number of people.

### **Market Developments and Innovation**

Research for the European Commission found the UK mortgage market is one of the most developed and advanced markets in Europe. As commented upon in the paper, there are 'thousands of products' available and the market is highly innovative, evidenced by the growth in flexible and offset mortgages for example. This demand driven innovation is in our opinion surely evidence of the success of the market. The lack of long-term fixed rates is, we feel, as a result of lack of demand, and not innovation. We have a concern that to try to stimulate the growth of a particular product area, such as long-term fixed interest rates, could lead to a series of unintended consequences which could threaten the stability of the market. Previous attempts to engineer product development that has not been founded in consumer demand have not met expectations. For example, simple mortgage products with defined terms on 'cost, access and terms' (the so-called CAT standard products) did not meet consumer needs and so had limited demand.

## **Miles Report**

We have commented on the successes of the Miles report extensively. However, we feel that the report, which was written in 2003, is of fading relevance to today's industry.

Since the 2003 report, the mortgage intermediary market has been subjected to the rigours of statutory regulation by the FSA. Further to this, and as acknowledged in your report, the data which forms the fundamental basis of the report is increasingly historic. For instance, at the time of the report 25% of mortgage products were fixed, usually for two or three years. However, the latest PSD from FSA demonstrated that 66% of mortgages were fixed in 2006/7, rising to 71% for advised sales, again demonstrating the value of advice.

At the time the Miles report was written, the economy was experiencing a period of prolonged growth with falling interest rates. The current less benign economic climate could suggest that the fundamental data of the original report is now less relevant.

## **Market Conditions**

A significant conclusion from the Miles report was the importance of funding mechanisms and mortgage-backed securities (MBS) for long-term fixed rates, including that "products would be funded efficiently and risk parcelled out (or removed) in a way that makes the cost minimal while generating acceptable returns for providers of financing and those that accept risk".

Whilst a Government-backed covered bond regime per se is unaffected by current market conditions, it is evident that a significant and fundamental market change is ongoing, with at present unknown duration and unquantifiable consequences. Given that MBS and parcelled out risk form the back-bone of the Miles report we would suggest a further review be undertaken to assess the proposals in light of the 'credit crunch' and the willingness of market counterparties to participate in new risk sharing vehicles.

## **Consumer Demand & Capability relating to Long-term Fixed Rates**

The key issue within the Green Paper is the adoption of longer-term fixed rates. With the Chancellor's comments that long term is 'ten years or even longer' in the recent Pre-Budget Report, we welcome the recognition that twenty-five year fixed rate durations are too long for the majority of consumers.

At present, there is a market for twenty-five year fixed rates. The market for shorter-term long-term fixed rates is even stronger, with a substantial number of lenders already offering competitive ten year fixed rates for instance.

However, demand for such products remains low, with consumers uncomfortable with the lack of flexibility of the products.

### **Affordability**

The Miles report also puts much emphasise on the attention paid to initial repayments on a mortgage. This is true, and has arisen as a result of the affordability strains caused by rising property prices. Government house building plans will alleviate this problem.

### **Practical Considerations**

Longer term fixed rates are useful products in certain circumstances. However, there are a number of situations where they would be unhelpful. For example, a twenty-five year fixed rate is unlikely to be viable for anyone over the age of forty, and the average demographic of a mortgagor in the UK is increasingly older due to affordability constraints of first-time-buyers.

Further, people buying a long-term fixed rate as their first mortgage could suffer severe detriment. The risk-profile, and therefore the cost of the risk, for a first-time buyer with no mortgage history purchasing at a high multiple of income at a high loan-to-value will be higher than for someone remortgaging several years later, with increased income and equity and decreased debt. By enforcing a long-term fixed-rate underwritten on the applicants' most high-risk profile, they could in effect be trapped into a far higher-rate of interest for a prolonged period.

A final consideration, again relating to underwriting risk, would be the increase in the sub-prime markets. We are currently seeing lenders' lending criteria tighten and it is expected that the sub-prime sector will increase in size. We urge consideration of how a consumer with a 'blip' on their credit history could be penalised into a long-term fixed rate based on their less favourable risk profile, rather than benefiting from the opportunity to improve their risk profile and remortgage to a longer-term rate product after a short period of 'credit repair'.

We also question whether insulating consumers from interest-rate movements, which is the effect of a long-term fixed rate, would in fact create an economy that is more difficult to control. It may be useful to review the American experience in light of recent credit problems and the impact on macro-economic management of the economy.

### **Conclusion**

Whilst AFB welcome the debate on assisting borrowers we do not feel that long-term fixed rates are necessarily the solution, nor in fact that the market is failing.

In some cases longer-term fixed rate mortgages can offer a degree of security and stability for borrowers, but it must be recognised that security comes at a

cost – hence higher interest rates or arrangement fees. While some consumers may be happy to pay more to receive this security, others are not. It is the role of the adviser to help draw-out the costs and benefits of such matters and arrive at a recommendation best suited to the borrower's personal circumstances.

Finally, we recommend that more study is undertaken before any proposals are progressed. With the European Commission undertaking an extensive programme of work on the credit market, the impact of the credit crunch still not clear, and the Government's housing-building policy set to be implemented, the housing market is in vulnerable position. The unintended consequences of further change could be dramatic, hence our desire to work with the DCLG to better inform policy making at this early stage.