The Mortgage Market Review

A borrower's guide to the new rulings from the FCA

XL Financial Services Limited

Be prepared

The Mortgage Market Review (MMR) outlines a clear set of rules which are being introduced to reinforce Consumer Protection, overseen by the Industry Regulator, The Financial Conduct Authority (FCA) and will be applied across the whole industry. We have outlined some of the ways in which the new rules will affect borrowers – and explain some of the changes that you will see when taking out a mortgage in future.

Taking out a mortgage could take longer than before

One of the main effects of the new rules will be to reinforce a clear distinction between mortgages sold on an "advised" or on an "execution-only" basis, with the overwhelming majority of sales being advised. **Some lenders – and most brokers – will only offer advised sales after 26th April.**

- The new rules are very prescriptive about giving advice, and the process is likely to take longer than before. Lengths will vary from lender to lender.

- It has been estimated that an advised sale could take up to two hours – perhaps longer – to complete. Even if you are making a change to an existing mortgage, you will be affected by the new rules and may find that the process takes longer than before.

Mortgage interviews may be longer because intermediaries might need to ask more questions to determine what mortgage product is suitable for you, taking into account your individual needs and circumstances. Questions that should be covered as part of the advice process include:

- What length of mortgage term is suitable for you?

- Do you need the stability of fixed monthly interest payments, bearing in mind the potential impact on your finances of future changes in variable rates?

- Is a mortgage offering lower monthly repayments at the outset an appropriate option?

- Is it likely that you will make early repayments?

- Should you have a repayment mortgage, an interest-only loan, or a combination of the two?

- Is it appropriate for you to pay any fees or charges upfront, instead of adding them on to the mortgage?

- What other loan features might suit your circumstances?

- Is the mortgage suitable, based on the information you provide and your credit history?

You may need to provide more details about your income and expenditure

One of the cornerstones of the new rules is that there must be a careful and detailed assessment of the affordability of the mortgage for you. This assessment has to focus not just on the affordability of initial payments, but future ones as well – in an environment in which interest rates may be higher, and allowing for changes in your circumstances that can be reasonably foreseen at the time you take out your mortgage.

The requirement to lend responsibly, and assess affordability, will mean that lenders must take into account your income, committed expenditure and other basic essential expenditure and costs reflecting your quality of living.

You can help yourself through this process by anticipating some of the questions the lender/Intermediary will ask and having to hand appropriate supporting evidence. Documents that may be needed to substantiate income from employment could include:

- Your three last monthly Payslips and last P60 from each job if you have more than one job and evidence of any other income being used to demonstrate affordability.

- Evidence of any overtime or bonus payments if these are not captured by payslips and a view of whether there is a level of consistency of bonus payment amounts.

- Three months of bank statements, which will help confirm that income is paid regularly; and if you make transfers to a separate bills account…you should also have these statements available too.

- Statements from your employer verifying any income that is not contractually guaranteed or which is irregular, including, for example, maternity pay.

If you are self-employed, you may need:

- Business plans and future projections of income.

- Tax returns and other details of tax paid - e.g. SA302.

- Business accounts, preferably independently prepared or verified.

- Statements or other verification of income from an accountant or other professional adviser.

Finally, if you want the lender to take into account other forms of income, you may need things like:

- Pension statements and projections.

- Annuity records.

- Statements of income from investments or rental properties.

You should also expect the lender/intermediary to ask about questions about any potential changes to your future income and expenditure – for example, forthcoming retirement, anticipated redundancy, a likely change to household income or maybe a desire to let the property out in the future. As with other requests from the lender/intermediary for information as part of the application process, it is important for you to answer as fully and openly as possible.

The new rules could affect how much you can borrow

Lenders will have to ask detailed questions about your spending and home life commitments. They will take into account any expenditure to which you are already committed, and will need to know about credit card and loan repayments, hire purchase agreements and child maintenance or alimony payments. They may want to know more about dependents too. You will be asked to provide evidence to help the lender make a realistic assessment of your commitments.

As customers you will also have to declare your spending on essential costs of living, including what you spend on utilities, council tax and telephones, ground rent, building and contents insurance, running a car, and other costs for traveling to work or school, including season tickets. You may also have to make a realistic estimate of other living costs, including clothing, household and personal goods, and recreation and childcare costs. Some lenders may use ONS (Office of National Statistics data to validate detail)

Another important commitment that lenders will need to take into account for interest-only borrowers is the cost of investments that form part of your strategy for repaying the mortgage at the end of its term.

The rules also require lenders to “stress test” affordability of mortgage payments against higher interest rates. In conversations with your Intermediary you will be asked and shown the impact of likely future interest rate movements over at least five years, based on market expectations (unless you opt to fix your rate for at least this period). Even if rates were expected to fall, lenders would still be required to assess affordability on the basis that there is a rise of at least 1% over the first five years.

Can I select my own Lender and Mortgage and would the same requirements surrounding documentation still apply?

Your advisor/intermediary is professionally qualified to provide you with advice and support, and this is a key part of an intermediaries’ service.

If you wish to proceed on this basis, this route is called Execution-only option. You will not be protected by the rules covering the provision of advice. In most cases, you will then have to confirm in writing that you are happy to proceed on that basis.

You, as the borrower, are the only one who can instigate an execution-only sale. It will be an option for you, as long as you can show you have researched the market and understand the features of – and commitments associated with – the mortgage you want to take out.

In most execution-only transactions, there can be no discussion between you and the lender. Most sales of this type are likely to be online.

Some lenders, and most brokers, will only offer advised sales.

It will still be possible for you take out an interest-only mortgage

The number of new interest-only mortgages has already contracted sharply, and some lenders have already decided to withdraw completely from this section of the market.

Lenders continuing to offer interest-only mortgages will need to ensure that you have a credible strategy for repaying the loan when it matures. They may accept a range of different strategies from you for this, and they will ask for evidence to support your chosen strategy. Examples could include:

- Regular deposits into a savings plan, or an investment product like an ISA. However, there may be requirements to provide supporting statements and projections of returns.
- The use of bonus payments or other irregular sources of income, again supported by evidence that could include payslips or statements from an employer.
- The sale of assets, supported by a valuation or other proof of value and ownership.

Conclusion

The majority of lenders are on course to implement the new rules for mortgage lending at the end of April, as anticipated. Some have already begun to switch their systems over and are already applying some of the new rules in practice.

You are therefore already beginning to see changes in the process of taking out – or even amending – a mortgage, and will definitely do so after 26 April 2014. The changes are being introduced to reinforce consumer protection.

You will see benefits from greater consistency in the approach to assessing whether the mortgage is affordable, and appropriate to your individual needs and circumstances. But, as this publication highlights, you may also see a process that is more thorough than you may have experienced in the past.

Your home may be repossessed if you do not keep up repayments on your mortgage.

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