Working together in an age of aspiration

Presentation by Michael Coogan, Director General of the Council of Mortgage Lenders to the Housing Market Intelligence Conference on 12 October 2010

Introduction

May I first of all thank the HBF for inviting me back for a second year to address this conference? Last year, some of you may recall I had a PowerPoint presentation on working together in a rationed funding environment.

This year, I propose to update you on some of the trends in the last 12 months, and I take my main inspiration from Grant Shapps' address in June on the "age of aspiration", and a new factor which will have a significant impact on the future housing market – the Financial Services Authority's regulatory approach to long-term risks such as mortgage finance.

If I can start with my conclusions!

First, the rationed funding environment has not improved – there will be less mortgage lending in 2010 than in 2009, and I would expect that reduction in business to flow into 2011, but we will publish CML forecasts in December.

Second, with a new coalition government with strong support for home ownership, it is important to identify measures to provide substance to delivering the age of aspiration. It will not be delivered by rhetoric, and is challenging in an age of austerity.

Third, the FSA's mortgage market review proposes a prescriptive approach to future affordability assessments to underpin responsible lending. However, the CML's analysis shows that there will be a number of unintended and adverse consequences for the new build sector.

Therefore, my main message to you today is that, if you have not taken an interest so far, you should read the FSA's consultation paper CP 10/16, you should review the CML's interim comments, and, most importantly, you should write to the FSA, your MP and to the HBF if you share our concerns about the impact on your businesses.

Those are my conclusions, but how do I reach them? It might be useful if I reiterate some of the key messages in my speech to this conference 12 months' ago.

I emphasised that a better future requires:

- A vibrant housing finance sector.
- A vibrant new-build sector.
- Responsive industry supply to match consumer demand.
- Affordable but appropriately priced products to reflect risk/costs.
- The government and industry working together.

So what has happened in the last 12 months?

As I have said, lending has decreased, rather than increased. It has also been concentrated in fewer and fewer lenders' businesses as our recent league table of the 30 largest mortgage lenders showed.

While some new products with high loan-to-values have come on to the market, it is clear that there is no significant change to the underlying problem for first-time buyers that they do not have a deposit to enable them to transact.

Consumer confidence has been impacted in advance of the comprehensive spending review, and uncertainty about their future disposable income has been added to by the announcement of the removal of Child Benefit. So, with more potential sellers post HIPS and buyers not in a hurry, it is no surprise that transaction numbers have started to weaken, and we are consequently starting to feel pressure on average house prices.

I will leave John Stewart to report back to you on the state of the new-build sector, and whether a more local approach to planning will enable the industry to be more responsive to consumer demand. I understand your uncertainty about the future with such a major change of housing policy approach from the previous administration to the new coalition government.

For myself, two concerns arose from listening to the direction of government policy at our recent future housing conference. First, I have not seen central government or local authorities engaging with the housing finance sector, nationally or locally, about how to move to financing the localism agendas?

I can see that there will be an opportunity for local and regional building societies to engage in initiatives that will help their members in their respective localities but, in the absence of economies of scale, I do not see the attractions for national banks and building societies in addressing the localism agenda proactively and positively. I hope I am wrong.

And, parochially, having got used to working with government through the Communities and Local Government department, it is going to be difficult for trade associations like the CML and HBF to develop coherent agendas that can support our members' activities in every locality around the UK through every local authority and devolved administration.

So, will a change in housing policy approach, and a change in partnerships from central government to local government, provide the better future we discussed 12 months' ago? We all await further details that will no doubt appear in the draft legislation soon.

However, we know that Grant Shapps' heart is in the right place from his keynote address in June, promoting home ownership as an achievable aspiration. Before today, I thought I would re-visit some of his comments, so that you can compare the 'tone' with his keynote address earlier today.

Then, he said, unequivocally “home ownership is a very good thing”.

A “tick in the box” from the CML.

He went on to say:

“This government will support you.
You will not be ignored.
The age of aspiration is back!”

Again, another “tick in the box”.

“Home ownership has provided personal and financial security to millions of people in the UK . . . I do not believe that it is right to deny the benefits of home ownership that we have enjoyed to the next generation.”

I could not agree more.

From the new build sector’s perspective, I also noted his comment

“. . . the real prize is we build more houses . . .”

And he also reflected that

“falling prices are bad for homeowners and builders alike, while soaring prices freeze out first-time buyers”.

It is particularly instructive to look at the first part of this comment in the light of the FSA’s approach to regulating the mortgage market. The FSA consultation paper on responsible lending highlights, if that is the word, in footnote 27 of the consultation paper that on both of the economic models it has used to assess the impact of its proposals, it expects “substantial” house price falls.

I am not sure whether anyone at the FSA read Grant Shapps' speech before producing its responsible lending proposals.

However, for the reasons I will explain, it is not too late for your sector to get involved in a public debate about where regulation should go.

Going back to my speech 12 months' ago, I suggested that what we needed was:

- **Time to heal the wounds and flush out past mistakes** (reflecting on the experience of some lenders of inaccurate valuations and new-build properties, particularly flats).

- **Funding diversification to meet demand** (while there have been tentative signs of improvement in the securitisation and covered bonds markets, we are still heavily reliant on retail funding which comes at a high price).

- **Competition between lenders for business at high loan-to-values** (we have had some more competition, between some lenders, at high LTVs. However, consolidation within the market continues, and the impact of new lenders, and I read that Tesco mortgages will be soon, is still to be felt).

- **Sensitive government policies which will assist all of the above** (until we see the full impact of the comprehensive spending review, it is not clear how far government policies will be sensitive to the particular needs of the housing and mortgage markets. I certainly have some concerns about the reduction in state support for mortgage interest, and the potential risks to future funding of debt advice, both of which could significantly and adversely impact on future arrears and possessions levels).

12 months' ago, I concluded that the CML and HBF will continue to work together, but it will take time to achieve the right results.

I was right back then and, regrettably, it remains true that despite our individual and collective efforts, we still have some way to go before the housing and mortgage markets will return to anywhere near "normality".

So, finally, I return to a new threat since my speech last year – the FSA's approach to mortgage regulation.

Some of you may be aware that I recently gave a speech at our future housing conference on "mortgage regulation – the law of unintended consequences". You may have picked up on some of the reports – I said that the golden age of home ownership was over, for the moment.

I rehearsed why we are worried about the cumulative impacts of layering of different regulatory requirements – describing them as "fatally flawed".

But, am I right? Let me know.

In summary, the FSA approach moves responsibility for borrowing decisions from the consumers to lenders, introducing a clear complaints risk with the Financial Ombudsman Service or regulatory risk with the FSA when borrowers at some time in the future say: "You should not have lent to me, it wasn't affordable."

Such a regulatory risk is unmanageable and, retrospectively, can have a huge impact on the bottom line of businesses, as we have seen in the past in the area of compensation for mortgage endowments, pensions and payment protection insurance.

It is no wonder, therefore, that mortgage lenders will pause for thought when lending to any customers without pristine credit records, and that means that some customer groups who have been well served by the UK mortgage market may be excluded in the future.

The second concern that the industry has is that the draft rules on affordability and income verification may be subject to a different interpretation and, consequently, retrospective action by the regulator.

We are looking to address this issue in our submission, but where the industry is not clear about what the policy objective is, or that the drafting of a particular rule meets the policy objective, it will, again, err on the side of caution. An intended or unintended consequence?

Thirdly, the responsible lending rules on income verification and affordability are on top of a European directive on responsible lending, due to be published early in 2011, and prudential rules on capital and liquidity which are still emerging from the Basle Committee (with respect to capital) and globally in respect of banking supervision going forward.

All of this means that the FSA has not yet assessed the cumulative impact of prudential requirements on banks' and building societies' capacity to lend going forward. We have consistently said, since the previous discussion paper on the mortgage market review, that it would be premature to introduce a new layer of conduct rules until we had an answer to the basic question on the impact on market activity of prudential supervision.

However, the analysis that we published on the conduct rules last week also raises a question mark about whether the FSA has fully considered the impact of its various responsible lending rules in its cost benefit analysis.

Having replicated the FSA methodology and approach to analysing the same data sources, we came up with significantly different numbers to the FSA.

Some of you may have seen the reports last week in which we highlighted that, if the FSA's rules had been in place in 2005-2009, the cumulative impact would have been to help around 200,000 people who have got into arrears or face possession to avoid that outcome by not lending to them on the mortgage terms they accepted.

However, while this is a clear and tangible consumer benefit, we also found that 3.8 million other loans which are performing would not have been granted on the terms that were actually taken out.

When we take this down to first-time buyers as a particular group of interest to house builders, we found that five per cent of first-time buyers have got into arrears or faced possession in the 2005-2009 period, who would not have done if they had not been allowed to proceed with their home purchase.

However, some 730,000 first-time buyers are still making their payments regularly, and have not got into financial difficulty, but who would not have been able to buy the house of their choice if the mortgage rules had been in place in 2005.

Adair Turner, the Chairman of the Financial Services Authority, has on two occasions invited a public debate on what should be the right approach to regulating the mortgage industry. Should it be to constrain consumer choice and seek to avoid the risk of arrears?

Or should it be to have a market where it is possible for consumers to achieve their aspiration to become home owners?

As part of our submission to the FSA, we have tested these questions with consumers.

The initial results have been published, and show that 85% of consumers aspire to become home owners in the next 10 years – that is the highest percentage in what has been a regular survey since the 1970s.

At the same time, we asked consumers of all ages and tenures what were the housing problems that they felt were most pressing? The highest percentage – around 80% – focussed on the problem of first-time buyers transacting as the most important issue to be addressed.

So, consumers confirm what we already knew, and Grant Shapps spoke about, we do live in an age of aspiration, and we should structure regulation to support this rather than to kill it at birth.

So, I would simply encourage you to take part in the public debate on whether it is right to protect the minority, or whether it would be better to provide an opportunity to the majority.

From a mortgage industry perspective, we can live with either outcome but, I think you will agree with me, the housing and mortgage markets would be poorer in every sense if we revert to a highly prescriptive, risk-averse, and limited market which serves the privileged few and excludes the majority.

The FSA's first outcome for the mortgage market review is to put in place a sustainable market for all participants, but we have already seen a shrinkage in the lending market since 2007, and a similar picture is visible in the mortgage intermediary sector (30,000 intermediaries down to a figure in the region of 10,000).

The second outcome is to provide flexibility for consumers. Rules which may have the unintended consequence of leading to the withdrawal of interest-only mortgages from the market, and limiting the options for existing borrowers to refinance or move, would not delivering on this objective either.

So, if I compare the situation today to the comments I made 12 months' ago, I have to conclude that it is not simply the government and industry working together, but we need the government, regulator, local authorities and industry working together to achieve better economic and social outcomes for the UK and all of us.

Something needs to be done to ensure financial stability, prevent responsible lending and discourage irrational borrowing.

However, that something is not the full panoply of responsible lending rules that the FSA is currently consulting upon, and I urge you to respond on behalf of your individual businesses to express your views, either supporting the FSA's or the CML's position, so that a fully rounded debate can take place shaping the kind of housing and mortgage markets we want in the next 10 years or more.

Thank you for your attention.

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