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# 21ST CENTURY WELFARE - A UNIVERSAL CREDIT

## RESPONSE BY THE BSA

1. This response relates to the proposals covered in Section 3 of the consultation, particularly in relation to the impact on Support for Mortgage Interest (SMI). We have not sought to respond to other aspects of the consultation.

2. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 49 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 21% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

### Principles of A Universal Credit

3. The BSA is supportive of proposals to streamline the benefits process and therefore support the principles for introducing a Universal Credit (UC). However, we are concerned with the impact that UC would have on the Support for Mortgage Interest (SMI) benefit. The proposals throw up a number of issues, particularly with SMI in its current form. We believe it is too simplistic to lump all employment and housing costs under the new process.

4. We acknowledge that SMI is not currently a benefit in its own right and that it is one component in the calculation of entitlement to income related benefits. However, SMI is paid separately and directly to lenders under the Mortgage Interest Direct scheme and this could potentially be lost under the UC proposals.

5. The proposals with UC currently have the potential to result in SMI not performing its main function (payment of the mortgage) and is instead used for other purposes, or it could become insufficient in terms of financial support.

### Impacts on Support for Mortgage Interest (SMI)

6. In the current economic environment, SMI for many claimants is a critical payment to avoid repossession. Based on figures provided in the DWP impact assessment published in August 2010[1], there were 225,000 customers receiving SMI as at November 2009. This is significantly more than the number of customers being assisted under other Government support schemes. As at June 2010, 980 homeowners have been accepted under Mortgage Rescue[2] far fewer placed on the Homeowner Mortgage Support Scheme.

7. Proposals to change the benefits system should therefore be carefully considered to avoid the consequence of driving up repossessions. We have some recommendations for enhancing SMI going forward, which are detailed further on. In terms of the UC proposals, we would comment as follows:

[1] http://www.dwp.gov.uk/docs/support-for-mortgage-interest.pdf
[2] http://www.communities.gov.uk/publications/corporate/statistics/mortgagerescuestatisticsq12010

### Ensuring SMI is allocated as intended.

8. Under the current system, SMI payments are made directly to the lender via the Mortgage Interest Direct (MID) scheme. This allows the lender to ensure the payments are allocated appropriately, thus ensuring the benefit is used as intended, to manage mortgage payments and avoid or stabilise arrears and ultimately avoid repossession.

9. If this scheme is removed under UC and the payment is made to the customer, this could result in the payment being used for another purpose, other than payment of the mortgage. For example, if the customer experiences some unexpected, yet necessary expenditure and leaves the mortgage unpaid.

10. There is also the likelihood that the SMI payment could be used to pay other charge holders, in particular where the first charge lender is exercising forbearance under FSA rules. Like first charger lenders, additional charge holders have the right to take possession of the property due to arrears.

11. Over the last year, our members report an increase in the number of instances where a second charge holder has sought possession of the property, even though the first charge lender was forbearing and comfortable with the arrears situation. Although a payment to the additional charge holder would potentially stop further action, the end result is that SMI is used for a purpose outside the current criteria and therefore being allocated by the customer, outside of anyone's control. The criteria is therefore not enforceable once the payments are granted, which we do not believe is appropriate.

### Calculating SMI under the taper system

12. We support the principle of a taper system, but depending on how this is ultimately set and managed, there could be the potential for the taper to have a detrimental impact, especially as SMI is not paid at the rate charged under the mortgage contract, but on a standard rate.

13. We already have concerns with the move to the Bank of England average rate in October. A number of our members have reported that it is likely to lead to a shortfall in payments towards the mortgage interest. Analysis of the impact can be found in Appendix 1. Further changes to reduce payments under a taper system could make this situation worse, therefore detailed analysis would need to be undertaken to ensure that SMI still provides adequate financial support for the majority of claimants.

### Removing Mortgage Interest Direct

14. It is also unclear how changes to payments would be communicated to the lender, assuming MID is removed. If the customer reduces payments to the lender, the lender will not know if this is due to the taper element kicking in (in which case the customer should in theory have income to support the shortfall), or if the customer is self selecting which payments to make.

15. The lender may adopt different strategies to handle these situations, in particular with how they engage with customers. For example deliberate non payment may result in further action by the lender to recover the arrears. A reduced payment due to the borrower finding employment is likely to result in further negotiations and agreement on managing payments going forward.

16. Prior to 1992, benefit payments towards SMI were paid to the claimant and only direct to the lender as a last resort. During the recession of the late 1980s and early 1990s, mortgage repossessions rose from 18,000 in 1989 to 75,000 in 1991[3]. The steep rise in repossessions led to claims that claimants were not passing the benefit payment onto lenders.

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[3] Murhpy et al 1994

17. In the current recession it is difficult to draw any parallel conclusions as the level of repossessions is much lower than in the early 1990s and can be explained primarily by the exceptionally low interest rate environment in which we are currently in. That said, we do know that of the 225,000 claimants as mentioned previously, 100% of these payments are being allocated to the mortgage payments because of MID. We therefore believe there is a strong case for continuing this scheme, even under the UC proposals.

**Reforming SMI**

18. We believe that SMI needs a fundamental overhaul to ensure it provides appropriate support to households who require assistance. We recognise the need to ensure that households take steps to protect themselves from a loss or reduction income, but SMI should be available as a last resort and should also provide an appropriate level of support based upon the homeowner's circumstances.

19. In 1995, the Government overhauled SMI for a number of reasons, many of which are also relevant today, such as the need to cut public spending. Other justifications included:

- the existing system constrained the development of private insurance
- reducing the benefit safety bet would lead to borrowers and lenders behaving more prudently.

20. Recent evidence demonstrates that the development of private insurance has not filled the gap to extent that it was needed. There has been much criticism of protection products, with regulatory intervention into payment protection insurance and other protection products being too complex, inflexible or not paying out when the customer is in need.

21. We have also found that in this recession the Government at the time introduced two other support schemes for homeowners in the form of Mortgage Rescue and Homeowner Mortgage Support. These schemes highlighted the fact that the current public and private safety nets are not sufficient. However, rather than introduce new schemes at a considerable cost, we believe that an overhaul to SMI, which can be scaled up or down depending on demand and economic circumstances, could have been more cost effective.

**The BSA proposals**

**De-link SMI from other employment related benefits**

22. The BSA recommends that SMI is de-linked from other employment benefits and made available to households who have suffered a reduction in income and not just a loss of income.

23. Unemployment figures during this downturn have not been as high as expected, with employers seeking to reduce working hours and overtime payments, rather than forcing unemployment. We believe that this demonstrates the need for a form of income protection, particularly where the reduction in income affects the homeowner's ability to pay their mortgage and therefore places their home at risk.

**Cover all secured loans**

24. The BSA recommends that the criteria is expanded to make cover all loans secured on the property.

25. A default on a loan secured on the property can ultimately result in repossession by the lender. We therefore believe it is sensible to ensure the borrower is as protected as possible from losing their home.

**Consider the payment as grant rather than a benefit for some homeowners**

26. SMI could be paid on the basis of a grant rather than a benefit, to those borrowers who are not eligible for income related benefits, but who are in need of short term assistance with their mortgage payments. These customers are more likely to be those with an earning potential above an agreed level, whose payment difficulties are temporary. The grant would be repayable at an agreed level once the homeowner is back in employment and could be secured by way of a charge over the property.

**Maintain the 13 week waiting period and the increased capital limit**

27. We strongly support the continued extension to SMI of the reduced 13 week waiting period
(previously 26 or 39 weeks), and the doubling of the capital limit from £100,000 to £200,000.

28. We believe it is important that the current SMI criteria is maintained, particularly until we move into more stable economic conditions.

## Appendix 1 Impact of SMI change

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

30. 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% |

31. This analysis demonstrates that the rate change is likely to have an adverse impact on a significant proportion of existing claimants, with a large proportion currently unable to increase payments from their own resources.

## Contact

32. This response has been prepared by the BSA in consultation with its members. Comments and queries in the first instance should be addressed to Victoria Barnard, Mortgage Policy Adviser (victoria.barnard@bsa.org.uk).

17 September 2010