FSA factsheet for

Mortgage brokers

FSA
Financial Services Authority

Interest-only mortgages and debt consolidation

This factsheet focuses on what to do if you are:
- **advising on interest-only mortgages**
- **advising on debt consolidation**

In this factsheet:

Advising on interest-only mortgages – Introduction

It is your responsibility to:
- discuss with your customers how they will repay an interest-only mortgage; and
- record details of the discussion and how they plan to repay.

This does not mean you must make your customer set up an investment or savings plan to repay the mortgage but you should 'sense check' what is proposed.

For example, while a mortgage adviser is not responsible for a borrower's investment strategy, if only a token amount is set aside each month to pay off a large capital sum, you need to consider what this tells you about the overall affordability of the mortgage contract. **Remember, it is your responsibility to assess affordability when giving advice.**

If your assessment of affordability relies on your customer converting to a repayment mortgage in the future you need to demonstrate the customer's circumstances will change so they will be able to afford this.

Note: If at any point in the sales process you decide a particular mortgage is not suitable for a customer the sale must stop and you cannot make a recommendation. Switching to a non-advised method to continue with the sale of an inappropriate mortgage does not treat the customer fairly and should not be done.

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Good practice

- The firm issued a key features illustration showing the mortgage on a repayment basis to all customers who assumed they could only afford an interest-only mortgage. This allowed the customer to consider both options before the firm did a full affordability assessment. If the firm recommended an interest-only mortgage it ensured there was a repayment strategy in place and explained the implications of an interest-only mortgage.

- The firm contacted customers with whom it had an on-going business relationship and who had interest-only mortgages to remind them to check their repayment strategies were on target. If they were not, they were advised to take steps to rectify the shortfall.
- If a customer intended to repay an interest-only mortgage with lump sums, the firm assessed their ability to do this.
- If the customer said they received bonuses or overtime, the firm reviewed the customer's bank statements to establish if they had received these payments previously
- If the customer was self-employed, the firm reviewed the customer's accounts to establish net profits, or if they were a director of a limited company, the amount of drawings over a period of time.

Summary

Firms who have incorporated treating customers fairly in their approach are able to show their advice is informed by a proper assessment of affordability rather than simply responding to a customer's desire for a mortgage (which may turn out to be unsuitable).

Before they recommend an interest-only mortgage, these firms also ensure customers:

- think about the consequences of taking out an interest-only mortgage;
- have a repayment strategy in place; and
- understand the need to review their repayment strategy to ensure it will cover their mortgage debt.

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Debt consolidation

What to take into account

If a customer's main purpose for seeking advice is to consolidate debts you must take account of the following (where relevant) in assessing suitability:

- the costs associated with increasing the repayment period;
- the appropriateness of the customer taking out secured debt; and
- if the customer has repayment difficulties, whether it would be more appropriate for them to renegotiate with their creditors rather than to add the debt to the mortgage.

Demonstrating suitability

Also, if you are recommending a debt-consolidation loan for a customer you need to be able to show it is appropriate and affordable. And you should bear in mind aspects such as any increase in cost from extending the payment term and the consequences of securing previously unsecured debt.

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Good practice

- The firm established whether the customer had spoken to their existing lender about borrowing more money to pay off the unsecured debts to avoid the costs of remortgaging.
- The firm asked customers before their appointment to have full details of their debts ready to supply accurate information about their outgoings for the affordability assessment. The firm encouraged them to get a copy of their credit report so it would have a record of the customer's payment obligations.
- The firm established whether the customer had payment difficulties. It took this into consideration when assessing whether it was in the customer's interest to secure more debt against their home, knowing that if the customer's spending habits did not change they risked being repossessed. The firm referred the customer to credit counselling or Citizens Advice if debt consolidation was not suitable.
- The firm recorded the amount of the unsecured debts and end dates to establish if the customer was better off repaying a short-term debt rather than increasing the amount of debt secured on their home.

- The firm completed a second affordability assessment if the customer could not consolidate all of their debt to ensure the customer could afford to pay the new mortgage, any remaining unsecured debt and their other monthly costs.

Summary

The best practice we have seen is where firms carried out a thorough fact-find to establish details of their customers' debts and their payment record and where they also asked their customers how good they were at controlling their spending and paying off their debts. Advisers considered this information before making a recommendation.

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