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Wealthy offered 'optout' from loan rules

By Tanya Powley

Wealthy borrowers may be spared tough "affordability" tests when taking out a mortgage, under revised proposals from the Financial Services Authority (FSA) for reforming the lending market.

Last month, after a two-year consultation, the regulator published what it calls "common sense proposals"aimed at preventing risky mortgage lending.

This latest draft of the rules retains a requirement that all mortgage borrowers must prove their income – effectively banning the self-certification mortgages that were dubbed "liar loans" during the housing market boom – and pass tougher "affordability tests" to ensure they can afford to make repayments.

However, the FSA has added a proposal that could see borrowers with a £1m-plus annual income or net assets of at least £3m made exempt from these rules, or given the option to opt-out.

"There is an argument that, above some level of income and wealth, it is perfectly reasonable for a consumer to take greater risks and that regulation is not needed to protect those consumers from the decisions they make," the FSA claims.

Having published its proposals, the regulator is now seeking more views on its definition of "high net worth" borrowers and whether they should be allowed such an exemption. Nevertheless, mortgage brokers think it likely that some concession will be made at the top end of the market.

According to Nigel Bedford of Largemortgageloans. com, an opt-out of regulatory requirements – similar to the "sophisticated investor" opt-out in the retail investment market – would be preferable to a blanket exemption.

"Having substantial wealth does not automatically mean a client feels financially astute enough to forgo protections afforded to other borrowers," he says. "It will then be a conversation that brokers will have with clients to see which route they prefer."

Other revisions to the proposed rules concern eligibility for interest-only mortgages – which were popular among wealthy individuals with annual bonuses or variable income levels. The FSA proposed a crackdown on them as its research found that, in 2007, 75 per cent of interest-only mortgages had no reported repayment vehicle. Now the FSA is no longer insisting that interest-only mortgages must be assessed for affordability on a capital and interest repayment basis. Instead, borrowers who can provide evidence of a "realistic and credible" repayment strategy will be assessed on their ability to meet only the monthly interest payments.

Ray Boulger of John Charcol, the mortgage broker, says this will help individuals looking to borrow seven-figure sums – as many would struggle to afford the loan on a capital and repayment basis but would have other ways to repay the mortgage, such as bonus income.

"There was a concern the FSA would be too black and white when it came to interest-only mortgages," says Mark Harris of SPF Private Clients. "We went from a situation where anyone could get an interest-only loan to one where almost no one could have one. Now we are beginning to find a middle ground."

In its proposals, the FSA has not specified any "credible" repayment strategies, apart from stating that they cannot rely on future house-price appreciation. But it suggests they could include regular savings into an investment product, sale of a second property, or periodic repayment of capital from bonuses.
Whether mainstream lenders will be willing to accept bonus income remains to be seen. Over the past two years, most banks and building societies have significantly tightened their lending criteria for interest-only mortgages .

"High street lenders are not generally happy to take bonus income into consideration as a method of repaying the mortgage," warns Aaron Strutt of Trinity Financial. "It is unlikely that they will allow bonuses to be taken into consideration for the foreseeable future."

In contrast, most private banks remain happy to rely on future annual bonuses – provided there is an established record of bonus payments, no reason for them to stop or reduce, and sufficient basic salary to meet the interest payments.

“Overall, the proposed changes in this latest consultation document will help wealthy clients have access to borrowing by maintaining the status quo,” says Bedford. ”This helps private banks by allowing them to continue to lend without undue and unnecessary restrictions.”