

Why Ninja mortgages could wreak havoc

Mounting evidence that borrowers are being given loans they can't pay is fuelling fears of Britain's own sub-prime crisis, writes Heather Connon

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In America, they call them Ninja mortgages - standing for No Income, No Job or Assets - and there is growing evidence that these sub-prime mortgages were mis-sold in their millions by lenders desperate to feed the pipeline for securitising, or packaging up, these loans by investment banks. Now legislators are looking at ways of tightening the regulations on everything from how such mortgages are sold to how they are securitised and rated by credit agencies.

In the UK there is growing evidence that sub-prime and self-certification mortgages (which do not require proof of a borrower's income) are being mis-sold, albeit probably not on the scale seen in the US. But so far it has hardly been remarked on, never mind subject to official investigations. That may be because, unlike in the US, our house prices are still rising, so borrowers in difficulties can always sell up.

But there are signs that the housing market is faltering. Last week, the chief executive of Barratt Developments, one of our largest housebuilders, warned that sales had dropped significantly in the two weeks since the Northern Rock crisis. Mortgage rates are rising and several surveys have found evidence of price falls. If the slowdown accelerates, many more borrowers could be in serious trouble.

Peter Tutton, social policy officer at Citizens Advice, says there is already evidence of borrowers being given unaffordable loans: 'If anyone was doing proper checking into the resources of the borrowers, they would see that they were unaffordable.' He cited a wide range of abuses: people on benefits are being granted mortgages with few questions asked about how they will keep up payments; people close to retirement age are taking out 25-year mortgages; borrowers are being encouraged to lie about their incomes.

'Some people are falling into arrears very soon after they take out their loans. The question, if that is happening, is how risky was the loan in the first place and how well was it assessed [by the lender]?' says Tutton.

That concern was borne out in research by the industry's regulator, the Financial Services Authority, earlier this year. It uncovered a range of poor practices by mortgage brokers - who now account for more than 60 per cent of all mortgages sold - and lenders. It found that in half the cases it investigated customers had self-certified their income, 'but it was not clear in many cases why they had been advised to do this', that 'significant numbers of consumers' had been advised to remortgage - and thus incur additional charges - 'without the adviser being able to demonstrate that this was beneficial to the customer', and that in a third of cases the intermediaries failed to assess properly the borrower's ability to afford the mortgages. Lenders had inadequate lending standards which they often failed to apply properly.

According to Which?, the consumer watchdog, the key reason for the poor practice is clear, and it is also the main

cause of several scandals that have blighted the financial services industry since the mass mis-selling of personal pensions 20 years ago: commissions. Endowment mortgages, now exposed as poor investments and often with excessive charges, were sold with great enthusiasm throughout the 1980s and 1990s by lenders keen to pocket the generous commission. Personal pensions were actively promoted by the government but, even without that support, the high commission would have made them attractive to intermediaries.

Now that brokers account for six in every 10 mortgages, commission is becoming a significant feature. Dominic Lindley, principal policy adviser at Which?, said: 'Whenever sales people are rewarded by commission, there is always an incentive to sell as much as possible.'

Commissions on sub-prime and self-cert mortgages are generally higher than on traditional mortgages. The Intermediary Mortgage Lenders Association (IMLA) estimates that procurement fees on sub-prime are generally around 0.5 per cent, compared with the 0.3 per cent payable on standard mortgages - and arrangement fees will generally also be higher. The larger the loan, the higher the commission - providing an incentive to encourage customers to take out as big a loan as possible. And the more lax the checks on income and status, the greater the risk that unscrupulous advisers will sell sub-prime or self-certification loans to borrowers who cannot afford them.

That may partly explain why the sub-prime market is the one of the fastest-growing areas: almost one borrower in five now has either a sub-prime or a self-cert mortgage and together they account for more than £50bn of all outstanding mortgages.

Peter Williams of the IMLA denies that these loans are being mis-sold, but admits: 'Everyone is influenced by the size of their reward. Commission is higher in the self-certified market, but I don't think that is the sole driver.'

High commission has also played a role in the selling of payment protection insurance. An FSA report last week said that, despite an inquiry by the Office of Fair Trading and several FSA reviews, too many lenders are still pushing these expensive and often useless products at all costs. 'We are extremely disappointed that some firms have still made little progress in improving their sales practices,' it said.

And a new Which? investigation into financial advice found that only half of all independent advisers and two thirds of tied advisers, who can only recommend a limited range of products, passed all its tests.

The FSA wants to encourage a move towards fee-based investment advice through its retail distribution review (RDR), which should be finalised next year. However, mortgage brokers are not included in the RDR, and not all consumers want to pay the fees.

Sutton says the industry is already 'reasonably well regulated' and there are certainly plenty of guidelines on treating the customer fairly and responsible lending, but the FSA needs to think about how to make the rules work more effectively. 'It is the same with PPI - we are into the third round of monitoring yet there are still significant problems. The question is - how do you get firms to comply?'

The FSA points out that it has taken action against a number of mortgage brokers - the latest, Select Mortgage Services, was fined £10,500. But the industry is very fragmented and, as long as the housing market kept rising, problems could be hidden.

A housing slowdown, combined with the looming end to almost 3 million fixed-rate mortgages, means borrowers could face rises in monthly payments of 15 per cent or more, leaving them more exposed. And that could thrust our own sub-prime crisis into the public arena.

Mis-selling: a brief history

- **Personal pensions:** in the mid-Eighties the government encouraged people to opt out of the state pension scheme

by giving them subsidies to set up personal pensions. Millions were urged to do so by financial advisers and pensions providers such as Sir Peter Davis's Prudential. In most cases, the advice was wrong and the consumers should have stayed in their company or state scheme: more than 2 million people were paid more than £6bn in compensation and companies and intermediaries were landed with hefty mis-selling fines.

- **Mortgage endowments:** in the Eighties and Nineties, housebuyers were steered into endowment policies to pay for their mortgages to the extent that they accounted for well over three quarters of all mortgages sold. It was not made clear to purchasers that these were linked to the performance of the stock market, that there was no guarantee they would pay out enough to cover the mortgage, or that the bank or building society selling them was raking in generous commissions. The stock market crash exposed their risks. The Treasury Select Committee estimated that as many as seven in 10 would have a shortfall, and that six in 10 had been mis-sold. Stock market returns since then have reduced the potential shortfalls but a host of companies have been fined for mis-selling.

- **Precipice bonds:** these were promoted by companies such as Lloyds TSB and Bradford & Bingley as guaranteed products offering generous returns of 10 per cent or more. In fact, the guarantee was for the income - and the stock market crash meant that the only way the firms could pay such returns was by eating up the capital, something which investors had no idea could happen. Huge compensation claims and, again, mis-selling fines quickly followed.

- **Payment protection insurance:** sold alongside personal loans, these policies are expensive, the get-out clauses wide - and the commission paid is often higher than the profit on the loan itself. Three reviews by the FSA, an Office of Fair Trading inquiry and huge publicity failed to discourage firms from trying to sell the policies. Mis-selling fines are mounting, though, and many customers are claiming their money back.

- **Split capital investment trusts:** these were promoted as suitable for widows, orphans and school fees. But many aggressively-promoted products concealed a web of crossholdings and a black hole of borrowings. So far, compensation has been limited and punishment mild.

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